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UNITED STATES-MEXICO ECONOMIC RELATIONS

HEARING

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

SECOND SESSION

SPECIAL HEARING

Department of Agriculture
Department of State
Department of the Treasury
Nondepartmental Witnesses

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UNITED STATES-MEXICO ECONOMIC RELATIONS

FRIDAY, DECEMBER 7, 1984

U.S. SENATE,
SUBCOMMITTEE ON FOREIGN ASSISTANCE,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 1:45 p.m. in the Phoenix City Council Chambers, Phoenix, AZ, Hon. Dennis DeConcini (member of the Foreign Assistance Subcommittee) presiding.

Present: Senator DeConcini.

Federal Government Panel

DEPARTMENTAL WITNESSES

OPENING STATEMENT OF SENATOR DECONCINI

BORDER ISSUES

Senator DECONCINI. I welcome all of you to the United States-Mexican economic relations hearings. I do not need to tell anyone in this room how important this issue is. In addition to the border, as I mentioned, the 2,000 miles we share together, we have an immense amount of problems, including trade, investment, immigration, drugs, and other border issues like sewage flows, water, and family relations.

CHANGES IN MEXICAN ECONOMY

It is my view that the key to United States-Mexico bilateral relations centers on economic issues. For almost all of the 50 years prior to 1982 Mexico was politically stable, inflation was under control and it was economically prosperous, at least by Latin American standards.

Mexico's economy boomed with the influx of oil revenues, and trade between our two countries increased substantially. However, in 1982 an economic crisis hit Mexico. Severe inflation skyrocketed. Mexico faced an enormous foreign debt. The United States joined with other nations to help Mexico, and Mexico undertook some severe fiscal and monetary polices to bring its economy under control.

Now, 2 years after the crisis first hit, seems to me to be an excellent time to evaluate both the status of the Mexican economy and the status of the economic relations between our two nations.

INTRODUCTION OF WITNESSES

We have testifying today a panel of three individuals who are extremely experienced in the border trade aspects of United States-Mexican economic relations. They are William Joffroy, the vice president, William Joffroy Custom House Brokers, Inc.; Mr. George Uribe, vice president of Western Mexico Vegetable Distributors' Association, and Mr. Edward Acosta of a Maquiliadora plant.

Following that panel will be a panel of distinguished experts in the foreign investment situation with Mexico. They will be Will Rapp, vice president, Valley National Bank; Jerry Ladman, director of the Latin American Affairs Center; and Vernon Penner, a Phoenix attorney.

Presenting the business and industry community's view will be Milton Whiting, chairman of the board of Kaibab Industries.

Also testifying from the Department of the Treasury will be Jim Conrow, Deputy Assistant Secretary for Developing Nations. From the Department of Agriculture will be John Montel. From the Department of State, George High, Director of the Mexican Affairs Office.

I hope the testimony will be of some significance. I hope we'll cover the entire spectrum of issues involved with our two countries. The economies of our two nations are, after all, quite different. We realize it and have realized it more and more as we have communicated with our neighbors to the south.

U.S. TRADE POLICY

The United States bases its trade policy on a group of international agreements and particularly the General Agreement of Tariffs and Trade known as the GATT. In contrast, Mexico places overriding importance on national development leading it to insist on autonomy in making investment and trade decisions. By necessity, such divergent economic policies are bound to cause disagreement. But necessity has also forced Mexico and the United States to cooperate with each other.

RIO GRANDE FOUNDATION

I hope this hearing today will identify areas of conflict and cooperation between the United States and Mexico. However, I also hope that this hearing might identify new initiatives for improving relations between our two countries. Along these lines I have prepared a proposal designed to impact on the investment side of the economic picture. I've entitled it the Rio Grande Foundation. The Foundation would serve as an independent financial organization to draw investment capital from both the United States and Mexico and then provide loans and other forms of financial and technical support to promote the expansion of existing companies and the establishment of new businesses for the betterment of both nations. I'll have this proposal inserted in the permanent hearing record, and I do not feel that this proposal is an absolute answer by any means to any of the problems that Americans have in dealing with Mexico. But I do believe that it's time to peer into and look at

and consider different proposals and get some ideas and see if there are some possible answers.

[The Rio Grande Foundation proposal follows:]

THE RIO GRANDE FOUNDATION

A BLUEPRINT FOR A MEXICO-UNITED STATES INVESTMENT AND VENTURE CAPITAL PROGRAM

Introduction

During a May 15, 1984 private meeting with President Miguel de la Madrid in Washington, D.C., U.S. Senator Dennis DeConcini proposed consideration of a new form of economic relationship between Mexico and the United States. He suggested that the two governments underwrite the establishment of an independent financial organization to draw investment capital from both countries. The new institution would then provide loans and other forms of financial and technical support to promote the establishment of new businesses as well as the expansion of existing companies.

A few points of introduction will shed light on the design of the DeConcini proposal. The economies of Mexico and the United States have taken distinct paths; yet important new relationships are forming between them. The economy of Mexico is developing its proficiency in many sectors of manufacture. With its energy and labor resources, Mexico promises to become a major production center for North America. As the United States' economy moves more strongly toward the provision of services and the development of high technology, it has enhanced its ability to provide the full range of capital, administrative and technical resources needed to support such production activities.

One major obstacle in the path of full development of the Mexican economy is a shortage of capital created by conditions in the international economy and a downturn in energy markets. The DeConcini proposal seeks to address these capital needs in a manner compatible with the historical relationships and national objectives of the two nations.

Based on the past experience of both countries, many traditional forms of financial or government-to-government arrangements would be inappropriate. A new form of financial relationship is needed, one which can build upon the deeply rooted relationships between our peoples. The citizen-to-citizen ties to Mexico have vastly expanded in recent decades, both as a result of the increase in the number of U.S. citizens of Mexican origin and also because of the vast number of U.S. citizens who have taken advantage of travel opportunities in Mexico. A new investment partnership between the two countries, based on individual investors, can fill important economic and social objectives, if it is successful in tapping the energies and imaginations of citizens in both countries.

Objectives of the joint program

The experience of existing bi-national and multi-national investment partnerships around the world provides important guidance on the objectives and functions which are likely to ensure a successful initiative. A common aspect of the more successful programs is that each addresses the full range of financial, management and technical needs of new and expanding businesses. This "full service" approach can be summarized in the following set of objectives for the organization herein proposed:

A. It should be capable of investing and loaning its own funds as well as borrowed funds in those enterprises that meet agreed upon economic objectives.

B. It should provide consultation on management and technical skills needed for the generation of new enterprises.

C. It should actively recruit participation.

D. It should promote the establishment of local and regional capital markets to further undertake support of new business.

E. It should base its lending and investment policies on the same needs for profitability that it seeks for its clients. Loans and other forms of financial participation should be based on market rates and practices.

F. It should support those bi-national programs already in existence to promote economic development and participate in them to the degree its organizational charter permits.

Shareholders and capital

The proposed investment and venture capital corporation would receive start-up funding from the two participating governments. Each would purchase a 10% participation. The remaining 80% of funding would be offered to the public of both countries in a manner which takes maximum advantage of available tax exemptions and preferences. For example, in the United States interest revenues from these bonds would be tax exempt. Funds invested in investment bonds might also be given special tax treatment. Only private citizens would be entitled to purchase investment bonds; and bond prices would be set at a level permitting the widest possible public participation. Care will be taken to assure that no group or family is permitted to accumulate a majority of shares.

Internal organization

A. Board of directors

The board would be the policy setting organ of the corporation as well as its highest decision making level. Membership of the board would be equally divided between citizens of the two nations who would be appointed by their respective Presidents. Board membership would be largely determined on the criteria of successful business experience.

The board would set overall policy, define priorities, supervise management and consider and approve large loan and investment applications.

B. Management

A general manager would be responsible for day-to-day activities and for the conduct of all other managers. The general manager would report to the board of directors and would have authority to make final decisions on small and medium-sized projects.

Internal divisions in the new organization would concentrate on the major objectives of finance, project development, management consultation and technical consultation.

Management development within the organization itself may be an important consideration, and consultant contracts with other successful bi-national or multinational investment programs may be sought for this purpose.

Borrowed funds

The foundation's own funds would be leveraged with borrowed funds from other private and international institutions. Standards for the terms of such borrowing and the debt-to-equity ratio to be maintained by the new corporation would be set in the organizing documents through negotiations between the two countries.

Use of resources

The investment policy of the foundation should involve the widest possible range of financial participation consistent with the laws of the two countries. Loans, minority equity participation, and guarantees are among the options to be spelled out in the incorporating documents and the policy decisions of the board of directors.

Expected performance

Success in attracting investment capital will largely depend on the quality and reputation of the board members and management. Assuming that early appointees inspire the necessary confidence, the prospects for significant participation are easily envisioned. Numerous U.S. citizens have sought to invest in the Mexican economy over the years but have found no convenient means for doing so. Numerous citizens of Mexico who have investment capital would be attracted by the stature and objectives of the new organization.

Conclusions

The proposed investment and venture capital program attempts to tap a resource that has not been fully utilized in building relationships between Mexico and the United States. It seeks to channel the imagination, ideals, and capital of the individual citizens of both countries into a program of economic expansion and cooperation.

This citizen-to-citizen approach puts the economic relationship of the two countries on a new footing and bypasses the many difficulties which have occurred in the past. Further, this approach serves to strengthen a broad set of relationships between our two countries. It promises a partnership that can build both economic prosperity and hemispheric harmony.

INTRODUCTION OF DEPARTMENTAL WITNESSES

Senator DECONCINI. I'm pleased to have such well-respected individuals here to testify today and believe that the testimony that the Foreign Operations Subcommittee receives will play a significant role in analyzing the issues that we have before us and in formulating appropriate United States policies for improving United States-Mexico economic relations.

We'll begin the hearings today with testimony from our panel of U.S. Government officials.

Gentlemen, if you would please step over to your right and my left.

The entire text of your statements will be inserted in the record following your oral presentations.

DEPARTMENT OF THE TREASURY

DEPUTY ASSISTANT SECRETARY FOR DEVELOPING NATIONS

STATEMENT OF JIM CONROW, DEPUTY ASSISTANT SECRETARY OF TREASURY FOR DEVELOPING NATIONS

MEXICO'S DEBT CRISIS IN 1982

Senator DECONCINI. We ask Mr. Conrow if he would begin, followed by Mr. High and Mr. Montel.

Mr. CONROW. Thank you, very much.

I welcome the opportunity to appear before this subcommittee to discuss Mexico's economic problems and prospects for the United States-Mexican economic relations.

Mexico was the country that signaled the so-called debt crisis in 1982. Its nonoil export earnings declined in real terms in 1980 and 1981 while its continued massive increases in investment outlays and imports resulted in unprecedented and unsustainable deficits in the balance of payments.

The deficit in the current account increased from almost $7.7 billion in 1980 to $14 billion in 1981. Growing loss of confidence in the face of Mexico's exchange rate rigidity and higher interest rates abroad resulted in accelerated capital flight. By August 1982 Mexico was unable to meet its maturing obligations.

COMMENDABLE ACTION BY MEXICO ON DEFICITS

Mexico's reaction has been commendable. To contain the external deficit, it endured growth rates of a negative 0.5 percent in 1982 and a negative 5.3 percent in 1983. There was a severe contraction of imports from $14.4 billion in 1982 to $7.7 billion in 1983 caused by the drop in economic activity and the sharp devaluation of the peso to a more realistic exchange rate. United States exports to Mexico immediately felt the consequences, dropping by 50 percent between 1981 and 1983, from $17.3 to $8.8 billion.

Other austerity measures included: Reduction, or elimination of subsidies in many public sector goods and services, most importantly, energy and food.

Improved tax collection resulting in increased Government revenues. Cuts in many Government activities, particularly public sector investment.

ASSISTANCE TO MEXICO FROM FOREIGN CREDITORS

Mexico's efforts to tackle its economic problems have been accompanied by extensive support from both foreign, private and official creditors. As the success has become more apparent, lending terms from private creditors improved and Mexico was the first country to receive a multiyear rescheduling from creditor banks.

Under this precedent-setting agreement about $48 billion in debt maturing in 1985 to 1990 will be rescheduled over 14 years at an average spread of 1⅛ over LIBOR. This represents a major step toward normal relations with the international financial community. The terms and conditions of this agreement serve as a basis for other multiyear reschedulings between commercial bank creditors and countries which have made successful adjustment efforts.

STABILIZATION AND GROWTH IN MEXICAN ECONOMY

In my text, Senator, I have gone into lengthy explanations of the origins of the Mexican problem and the particular crisis that occurred in 1982, and I also outlined the details of the Mexican stabilization program. In the interest of time, I will just let that stand on the record and proceed to the point that Mexico has achieved most of its adjustment goals and appears determined to stabilize and grow.

After increasing to 17.8 percent of GDP in 1982, the public sector deficit was reduced to 8.5 percent in 1983 and is expected to decrease further in 1984 and 1985.

Inflation is expected to be under 60 percent this year, down from 99 percent in 1982 and 80 percent in 1983. It is expected to decrease further in 1985 and could be as low as 35 percent.

Public sector external borrowing was reduced to $5 billion in 1983 and $3.8 billion in 1984. It is expected to be $1 billion at most in 1985.

A current account surplus of $4 billion or more is expected this year, easing somewhat to about $2 billion next year, as imports recover.

DEVALUATION OF PESO

The peso is being devalued by 13 centavos a day. I would point out that yesterday the Central Bank of Mexico announced that they have increased that rate to 17 centavos a day. Despite Mexico's impressive performance to date, the job is not done and a number of steps need to be taken to consolidate gains to date and to assure a viable medium-term basis for growth and development.

Mexico must move away from excessive Government involvement in the economy; an overinvolvement that threatens to strangle the private sector and continues to fuel excessive budget deficits. They must also eliminate domestic bottlenecks caused by excessive subsidies and price controls.

MEXICAN TRADE LIBERALIZATION POLICIES NEEDED

Mexico must also remove the complex of barriers to free trade that isolate the Mexican economy from the world and contribute to inefficient resource allocation.

Mexican trade liberalization is crucial if nonoil exports are to become truly competitive and foreign exchange sources are to become diversified.

A more realistic and less ideological approach toward foreign direct investment is clearly needed.

An improved foreign investment climate and a corresponding increase in private direct investment inflows to Mexico are critical elements in reducing Mexico's dependence on potentially volatile bank funding, funding that is generally inappropriate for long-term development finance.

Mexico has managed in recent years to adopt policies that worsen rather than improve its investment climate. This has been at a time when bank lending to Mexico has been quite difficult; a time when stable capital inflows should have been nurtured as part of a medium-term development strategy.

NEGATIVE EFFECT OF PHARMACEUTICAL DECREE

I already noted the negative effect in part of my testimony on the pharmaceutical decree issued in February of this year. That decree increased GOM involvement in the licensing, production, pricing, and marketing of pharmaceuticals with the aim of increasing the market shares of Mexican labs at the expense of United States firms that had invested in the Mexican market in good faith.

But the pharmaceutical decree was neither the first nor the only impediment raised to investment and improved trade relations in recent years. Mexico issued new auto regulations in September of 1983 which increased local content and performance requirements, impinged on auto production and planning decisions, and reserved the medium-weight truck market for Mexican producers.

In July 1984 the Government of Mexico also issued a new national plan for industrial development which applies outright prohibitions and extensive controls on several other sectors of the Mexican economy.

The most recent negative element in the foreign investment climate occurred in August when the Government of Mexico submitted a draft of its electronics sectoral decree, a decree far more restrictive than its 1981 precursor.

TRADING ENVIRONMENT

Let me turn for a moment to the trading environment. Mexico's export subsidies, restrictive licensing practices, and trade-related investment restrictions have been additional areas of contention. While Mexico is attempting to rationalize its trade system through a replacement of most import licenses with tariffs, progress has been extremely slow.

However, some progress was made on the export subsidy issues when the Mexicans suspended application of their main export subsidy program. In an ad referendum bilateral agreement negotiated with the United States in 1983, the Mexicans promised not to reactivate the CEDI Program to eliminate other export subsidies. In return, we agreed to apply countervailing duties only if injury to U.S. producers is proven. Subsequently, we postponed finalizing that agreement until the Mexicans change the recent pharmaceutical decree to remove its negative impact on United States investors.

AGREEMENT ON TRADE AND INVESTMENT FLOWS

Despite the variety and complexity of, and frustration caused by Mexico's trade and investments policies, the United States is still trying to establish a framework for an agreement defining the principles for trade and investment flows between our two nations. Such an agreement would greatly facilitate decisionmaking by Mexican subsidiaries of United States firms and would give our two countries a reference point for resolving remaining problems and avoiding new ones.

We understand the frustration of American exporters and investors in dealings with the Mexican environment. We are, nonetheless, confident that the situation can be improved if market forces are permitted to work and Mexico actively pursues the benefits of a more open economy.

In conclusion, Mr. Chairman, I have reviewed the circumstances leading to Mexico's present situation and touched upon some of the issues central to United States-Mexican relations. I've attempted to be candid in my comments in the hope that by airing these issues more fully a greater determination and resolve can be marshaled to their resolution.

Mexico is an important trade and investment partner, and United States-Mexico relations should be enhanced. With that in mind, we will continue to work towrd viable economic solutions with Mexico. This process, however, is a two-way street. Both parties must be willing to work and cooperate if we are to achieve this goal.

Thank you.

PREPARED STATEMENT

Senator DECONCINI. Mr. Conrow, thank you very much for your testimony. We appreciate the time you spent in putting together your full statement.

[The statement follows:]

PREPARED STATEMENT OF JAMES CONROW

DEPUTY ASSISTANT SECRETARY OF TREASURY FOR DEVELOPING NATIONS

Mr. Chairman, I welcome the opportunity to appear before this subcommittee to discuss Mexico's economic problems and prospects for U.S. - Mexican economic relations.

Mexico was the country that signalled the so called debt crisis in 1982. Its non-oil export earnings declined in real terms in 1980 and 1981 while its continued massive increases in investment outlays and imports resulted in unprecedented and unsustainable deficits in the balance of payments.

The deficit in the current account almost doubled -- from $7.7 billion in 1980 to $14 billion in 1981. Growing loss of confidence in the face of Mexico's exchange rate ridigity and higher interest rates abroad resulted in accelerating capital flight. By August 1982 Mexico was unable to meet its maturing obligations.

Mexico's reaction has been commendable. To contain the external deficit, it endured growth rates of -0.5% in 1982 and -5.3% in 1983. There was a severe contraction of imports from $14.4 billion in 1982 to $7.7 billion in 1983 caused by the drop in economic activity and the sharp devaluation of the peso to a more realistic exchange rate. U.S. exports to Mexico immediately felt the consequences, dropping by 50% percent between 1981 and 1983, from $17.3 billion to $8.8 billion.

Other austerity measures included:

- Reduction, or elimination, of subsidies in many public sector goods and services, most importantly energy and food.
- Improved tax collection resulting in increased government revenues.
- Cuts in many government activities; particularly public sector investment.

Mexico's efforts to tackle its economic problems have been accompanied by extensive support from both foreign private and official creditors. As the success has become more apparent, lending terms from private creditors improved and Mexico was the first country to receive a multiyear rescheduling from creditor banks.

Under this precedent-setting agreement, about $45 billion in debt maturing in 1985-90 will be rescheduled over 14 years at an average spread of 1 1/8% over LIBOR. This represents a major step toward Mexico's return to normal relations with the international financial community. The terms and conditions of this agreement serve as a basis for other multiyear reschedulings between commercial bank creditors and countries which have made successful adjustment efforts.

ORIGIN OF MEXICO'S DEBT PROBLEM

Mexico's debt problem developed from a combination of domestic policies based on optimistic assumptions about export growth and interest rates and a delayed reaction to adverse external developments.

During the late 1970's, the Lopez-Portillo administration sought rapid economic growth as a means of increasing employment. The program assumed that oil export volumes and prices would be sustained and that ready access to international capital markets would be maintained. Unfortunately, the rapid rate of economic growth (real GDP averaged 8.5% for 1978/81) created serious structural bottlenecks which ultimately led to an inflation rate of 99% in 1982 from 29% in 1981. Instead of moderating its high-growth program, Mexico simply increased imports to ease supply bottlenecks.

Mexico also fueled inflation and generated large public sector deficits with expansive monetary and fiscal policies. This spurred increased external borrowing; particularly short-term bank loans. The government sought short-term financing in an attempt to avoid locking in what it viewed as high long-term interest rates. This tactic, of course, backfired as the six-month LIBOR jumped from an average of 9.2% in 1978 to 16.6% in 1981. Finally, Mexico persisted in an over-valued exchange rate in a vain attempt to contain the peso cost of the growing foreign debt service burden.

This policy approach, as I already indicated, led to sustained capital flight that was exacerbated by the unwillingness of the GOM to deal effectively with a deteriorating financial position.

But, not all the blame for the 1982 crisis can be laid to domestic policies. External factors played their role as well.

- Deep recession in the industrialized world after 1979-80, which reduced demand for Mexican petroleum put downward pressure on oil prices;

- Record interest rates left Mexico (which had borrowed money at negative real terms) with a rapidly increasing real debt service burden.

-- <u>The Debt Crisis</u>

The announcement on August 17, 1982 that Mexico was unable to honor its external debt obligations was preceded by several events that pointed toward trouble ahead.

In June 1981, Mexico lowered its oil prices because of the softening of the oil market. This resulted in foreign exchange losses that were made up by increased short-term external borrowing. When the 1982 budget was announced in October, 1981, the public sector deficit was projected at 8% of GDP -- two points higher than 1981.

Despite President Lopez-Portillo's assurances that the peso would not be devalued, the peso:dollar rate was forced down by 362 percent in six months. By August 3, 1982 Mexico's gross reserves were under $1.4 billion, with little of that being liquid. By August 13, Mexico had created a two-tier exchange system and had stopped converting pesos to dollars.

The initial reaction of the international monetary system to the Mexican announcement was near panic and fear that other major debtors such as Brazil, Argentina, and Venezuela would follow in Mexico's footsteps and cause irreparable damage to the world financial system.

Thanks to the close cooperation between Mexico, official and private creditors, and the IMF and Mexico's willingness to

implement a major austerity program, serious disruption of the financial system was minimized.

MEXICO'S STABILIZATION PROGRAM

Mexico successfully adjusted to its payments crisis with a prescription of major policy measures including:

- Devaluation of the peso in real terms by 32% in 1982 and by another 13% in 1983, and avoiding overvaluation in the future.
- Reduction of imports by 40% in 1982 and by 45% in 1983, leaving them at one-third their 1981 level.
- Reduction of the public sector Deficit/GDP ratio from 14.9% in 1981 to under 12% a year later.
- Slowed monetary expansion.
- Cutting net public sector external borrowing to $11.0 billion in 1982, compared to $18.0 billion in 1981.
- Encouragement of domestic savings with competitive interest rates.
- Reduction of the 1982 current account deficit to under $5 billion compared to nearly $14 billion in 1981.

Mexico achieved most of its adjustment goals and appears determined to perservere in its efforts to stabilize and grow.

- After increasing to 17.8% of GDP in 1982, the public sector deficit was reduced to 8.5% in 1983 and is expected to decrease further in 1984 and 1985.
- Inflation (national CPI) is expected to be under 60% this year, down from 99% in 1982 and 80% in 1983. It is expected to decrease further in 1985 and could be as low as 35%.
- Public sector external borrowing was reduced to $5.0 billion in 1983 and $3.8 billion in 1984. It is expected to be $1.0 billion, at most, in 1985.
- A current account surplus of $4.0 billion, or more, is expected this year, easing somewhat to about $2.0 billion next year, as imports recover.
- The peso is being devalued by 13 centavos a day (the controlled rate is now Ps.186.23/$US while the free market rate is Ps.215/$US).

--Future Steps the Mexicans Need to Take

Despite Mexico's impressive performance to date, the job is not done and a number of steps need to be taken to consolidate gains to date and assure a viable medium-term basis for growth and development.

- Mexico must move away from excessive government involvement in the economy; an over-involvement that threatens to strangle the private sector and continues to fuel excessive budget deficits.
- They must also eliminate domestic bottlenecks caused by excessive subsidies and price controls.

- Mexico must also remove the complex of barriers to free trade that isolate the Mexican economy from the world and contribute to inefficient resource allocation.

  - Mexican trade liberalization is crucial if non-oil exports are to become truly competitive and foreign exchange sources are to become diversified.

- A more realistic and less ideological approach toward foreign direct investment is clearly needed.

- An improved foreign investment climate and a corresponding increase in private direct investment inflows to Mexico are critical elements in reducing Mexico's dependence on potentially volatile commercial bank funding -- funding that is generally inappopriate for long-term development finance.

U.S. - MEXICAN ECONOMIC RELATIONS

As you well know, the U.S. and Mexico are inexorably linked, both geographically and economically. The U.S. is Mexico's largest trading partner and some 2,900 U.S. companies have direct investments in Mexico amounting to $5.5 billion, or more. In addition, the U.S. has sharply increased imports from Mexico since 1981 and we have seen our trade deficit with that country grow from $4.5 billion in 1982 to $7.9 billion in 1983. While the bilateral trade deficit with Mexico has eased somewhat in 1984, the U.S. market continues to provide over $6 billion per annum in net foreign exchange receipts to the Mexican market. A strong economic recovery in the United States has been one of the principal supporting elements for Mexico in the period immediately following the 1982 financial crisis. The openess of our markets is a clear indication of the seriousness of our commitment to maintain and improve our bilateral relations.

Because of the presence of so many U.S. companies in Mexico, we are sensitive to economic developments there and, in particular, are quite concerned about Mexican policy toward U.S. companies and their Mexican subsidiaries. Several recent policy developments have caused us serious concern in this area. As an example, the Mexican pharmaceutical decree of February 1984 could force U.S. firms out of the Mexican market and several elements of that decree appear to be contrary to Mexico's self-interest, despite their political appeal.

As I have already noted, Mexico needs to rely less on bank financing and more on private direct investment inflows. To this end, Mexico needs to seriously consider deregulation of its domestic market to permit dynamic market forces the space to allocate scarce resources more efficiently.

-- The Investment Climate

Mexico has managed in recent years to adopt policies that worsen, rather than improve its investment climate. This has been at a time when bank lending to Mexico has been quite difficult; a time when stable capital inflows should have been nurtured as part of a medium-term development strategy.

I already noted the negative effect of the pharmaceutical decree issued in February of this year. That decree increased GOM involvement in the licensing, production, pricing, and marketing of pharmaceuticals with the aim of increasing the market share of Mexican labs at the expense of U.S. firms that had invested in the Mexican market in good faith.

But, the pharmaceutical decree was neither the first, nor the only impediment raised to investment and improved trade relations in recent years. Mexico issued new auto regulations in September 1983 which increased local content and performance requirements, impinged on auto production and planning decisions, and reserved the medium-weight truck market for Mexican producers.

In July 1984 the GOM also issued a new national plan for industrial development (PROFICE) which applies outright prohibitions and extensive controls on several other sectors of the Mexican economy.

The most recent negative element in the foreign investment climate occurred in August, when the GOM submitted a draft of its electronics sectoral decree; a decree far more restrictive than its 1981 precursor.

-- The Trading Environment

Mexico's export subsidies, restrictive licensing practices and trade-related investment restrictions have been additional areas of contention. While Mexico is attempting to rationalize its trade system through a replacement of most import licenses with tariffs, progress has been extremely slow.

However, some progress was made on the export subsidy issue when the Mexicans suspended application of their main export subsidy program (CEDI). In an ad referendum bilateral agreement negotiated with the U.S. in 1983, the Mexicans promised not to reactivate the CEDI program to eliminate other export subsidies. In return, we agreed to apply countervailing duties only if injury to U.S. producers is proven. Subsequently, we postponed finalizing the agreement until the Mexicans change the recent pharmaceutical decree to remove its negative impact on U.S. investors.

-- Looking for A Solution

Despite the variety and complexity of, and frustration caused by Mexico's trade and investment policies, the United States is still trying to establish a framework for an agreement defining the principles for trade and investment flows between our two nations. Such an agreement would greatly facilitate decision-making by Mexican subsidiaries of U.S. firms and would give our two countries a reference point for resolving remaining problems and avoiding new ones.

We understand the frustration of American exporters and investors in dealing with the Mexican environment. We are, nonetheless, confident that the situation can be improved, if market forces are permitted to work and Mexico actively pursues the benefits of a more open economy.

CONCLUSION

Mr. Chairman, in my testimony I have reviewed the circumstances leading to Mexico's present situation and touched upon some of the issues central to U.S./Mexican relations. I have attempted to be candid in my comments in the hopes that, by airing these issues more fully, a greater determination and resolve can be marshalled to their resolution.

Mexico is an important trade and investment partner and U.S.-Mexican relations should be enhanced. With that in mind, we will continue to toward viable economic solutions with Mexico. This process, however, is a two-way street. Both parties must be willng to work and cooperate if we are to achieve this goal.

DEPARTMENT OF STATE

OFFICE OF MEXICAN AFFAIRS

STATEMENT OF GEORGE HIGH, DIRECTOR, OFFICE OF MEXICAN AFFAIRS, DEPARTMENT OF STATE

INVESTMENT AND TRADE CONSIDERATIONS

Senator DECONCINI. We'll now hear from Mr. High.

Mr. HIGH. Senator, I'm George High, the Director of Mexican Affairs in the State Department.

I want to discuss some of the aspects and implications of our relations with Mexico and particularly how they affect and relate to investment and trade.

Among the general considerations I think we have to focus on is the fact that our relationship with Mexico is very complex, very diverse, at least as complex and diverse as with European countries and with Japan. Our relations with Mexico are very good. President de la Madrid has described them as being mature. By that he means that they are positive, that there are many favorable elements. When we have problems and differences, we discuss them seriously, and we try to narrow them down and try to resolve them.

UNITED STATES-MEXICAN RELATIONS ON HIGH NOTE

There is, to be sure, a lot of historical baggage that goes into our relationship. There were periods in the past when we haven't had good relations, when we've had differences and irritants. To be sure, that impacts from time to time on our relationship. But I still want to stress that the major element of our relations is a very good and positive one. Our Presidents have very positive personal relations. They're both committed to enhancing understanding and to solving problems. Cabinet ties are the same way. Several weeks ago secretary of State Shultz met with Secretary Sepulveda. This week Energy Secretary Labastida is in Washington. Ambassador Gavin has broad and effective ties throughout Mexico. The Mexican Ambassador likewise has many contacts in the United States. There is, as you know, as well the interparliamentary meetings each year in which our Congresses get together to discuss problems of mutual interest for several days. Right now Congressman Bill Richardson is in Mexico City with a delegation from the Hispanic caucus. It is on its way to Central America. There is, in addition, far more contact and involvement between state governments and in the private sector.

We need to realize that because of the depth and breadth of our relations and their importance. There are going to be major issues

to resolve, just as there are with Europe, just as there are with Japan. As a point of reference for discussion this afternoon, I think we need to say that it is United States policy to see a strong, independent, and economically developing Mexico. We have nothing to gain from a Mexico that's weak. Consider, for example, the decline in our trade and investment with Mexico over the last 2 years or consider the fears that some people have of the dangers offered to both countries by instability in Central America.

MEXICAN ECONOMIC CRISIS OF 1982

The Mexican economic crisis of 1982, which has had its continuing effects today and well beyond, is a major factor in our relationship. GNP was reduced 6 percent. Per capita income was reduced 10 to 15 percent. The impact was severe. It hit all sectors of the Mexican economy, particularly labor, and the countryside, and business, the middle class.

The Mexican response has been very positive. There were budget cuts, reductions in Government programs and subsidies, currency devaluation, reductions of imports. The Government sought to spread the burden to assure that there was an equitable balance. That assured support from labor. This stabilization program has required leadership and courage, and it's required sacrifice by the Mexican people.

The results have been very positive. The debt was stretched out. Confidence has been restored. Interest rates have been reduced. Mexico's leadership has been applauded. The situation has improved, but President de la Madrid noted in his state of the union speech last September much still remains to be done. The problems are not entirely solved. Some in Mexico who came through these trying times remain very pessimistic. There is also a very active cynicism in Mexico which is disconcerting, particularly to foreigners and the influence it sometimes has to foreigners.

STRENGTH OF MEXICAN RESOLVE

I want to make several points to keep this in perspective. America has had a tendency every decade or so to project doom and gloom in Mexico. But Mexico has progressed, it's prospered, and it's made it through those problems. When Americans talk of Mexican stability, these words are seen in Mexico as code words for latent American interventionism. We have no such intentions. We have no such interest. Mexican leaders are alert to their problems. They are not complacent.

Supporters of the domino theory, or who worry about stability, overlook the strength and flexibility of Mexico institutions.

I do not make light of Mexico's problems. We need to be alert, concerned, and helpful. We also need to keep a sense of balance and proportion, recognizing that Mexico has longstanding, proven institutions. People do us and Mexico a great disservice, I think, when they succumb to pessimism.

INTERDEPENDENCE AS PROBLEM SOLVER

What should be done? How can we be helpful? How can we protect our interest? The answer lies I think in recognizing our interdependence. We speak of a special relationship with Mexico and, of course, as neighbors we have special relations. But often the focus has been on what special concessions can we offer Mexico and that's where it stops. We must relate to Mexico's special circumstances, especially in difficult times. But we have to recognize that we have a focus that is much broader as well both graphically and in terms of the evolution of our economies in both countries.

UNITED STATES-MEXICAN RELATIONS

Relations between Mexico and the United States cannot be based on the assumption of permanent economic asymmetry. The Mexican economy has grown. It's diversified. This will continue. Increasingly United States-Mexican economic policies must be based in our view on mutual interests and responsibilities, of give and take.

United States policies must recognize that we respond to regional and worldwide responsibilities as well as looking after our special situation with Mexico. There has to be coherence between those.

Also our resources are severely limited even with the wealth we have and particularly in terms of our responsibilities, both domestically and internationally.

In this conceptual framework, I believe reasonable observers will conclude our economic posture toward Mexico has been positive.

UNITED STATES TRADE RELATIONS WITH MEXICO

Mexico is our third leading trade partner. It's our most important foreign source of petroleum. Mexico wants to maintain United States markets as open as possible so it can pay for its imports and make debt payments. The United States is also eager to retain and expand markets in Mexico. U.S. exports stood in 1981 at $17.4 billion. They were at $9.1 billion in 1983. From January to August they stood at $7.7 billion.

Mexico criticizes us frequently as protectionist. They're concerned when they see projects in Congress which are considered as being protectionist. In fact, our markets are the most open in the world. Moreover, the Congress recently renewed the generalized system of preferences for 8½ years. GSP products exported by Mexico and the United States amounted to three quarters of a billion dollars last year. The average rate of duty is low on products imported from Mexico and nontariff barriers are only limited to a few cases.

On the other side of the coin, Mexican exports in 1981 stood at $14 billion. Mexico exported in 1982 $15.7 billion and $16.8 billion in 1983. This year from January to August it was $12.1 billion.

EXPANSION OF MEXICAN MARKETS IN UNITED STATES

Mexico's markets have expanded in the United States, yet Mexico is concerned over countervailing duties. I won't go into a discussion at this particular point on the agreement under discussion between us.

We are criticized that there's no overall trade agreement. People claim what we have is an ad hoc relationship with Mexico. We would like to strengthen the framework of our trade relationship with Mexico, and we're prepared to move on this now.

We need to recognize that there is a very broad dialog that has been going on for a long time between the United States and Mexico on trade matters, and that there are mechanisms, such as the Joint Commission on Commerce and Trade, which can be improved upon or used to expand trade. But what really is at the heart of an improved trade relationship between the United States and Mexico are will and flexibility to resolve problems, and that is required by both countries.

INVESTMENT IN MEXICO

In terms of investment, there are $4.5 billion of United States investment in Mexico. It represents 68 percent of total foreign investment. West Germany is second with only $864 million.

Foreign investment amounts to 4 percent of total private investment in Mexico, or if you include the private sectors, 2.5 percent of investment.

The Mexican Government determines the rules which presently require that 51 percent of a firm that has foreign investment be owned by Mexico.

Businessmen, during the economic crisis in 1982 and 1983, encouraged Mexico to change its legislation. The Mexican Government responded that it couldn't, but it did indicate sectors of the economy in which it encouraged more foreign investment. It simplified some procedures, and it stated that there would be flexibility in interpreting the law.

INVESTMENT CLIMATE IN MEXICO

Mexico's investment climate has a number of positive factors: market, skilled workforce, infrastructure, raw materials. It has the reputation of President de la Madrid and a very effective economic team. It has the success of its stabilization program and recently it has the divestiture of shares that it gained through the bank nationalizations. All of those are positive.

There are negative ones as well. The shocks from the crisis of 1982, nationalizaiton of the banks, forced conversion of dollar accounts, concern over centralization trends and growing public sector domination of the Mexican economy. Mexico has new regulations on pharmaceuticals and proposed ones on other sectors. There is the recent question of how Mexico will decide on the IBM proposal for 100 percent equity investment in a project that it's interested in.

There still are heavy bureaucracies. Businessmen tell us that while Mexican authorities speak of encouraging foreign investment, when you deal with the bureaucracy the rules are the same. The fact of the matter is there's little new investment even with the Ford and GM deals.

According to the Mexican Secretariat of Finance, the amount of new foreign investment authorized in 1982 stood at $1.5 billion; more than double what it was in 1983. But the Bank of Mexico fig-

ures for actual investment flows for the first 6 months 1984 stood at only $80 million, compared to only $373 million 1983. The signals are mixed. That's what businessmen tell us. If you consider that Mexico needs to provide jobs for nearly 1 million entrants into the job market each year, if you recognize that domestic investment in Mexico is not likely to provide funds for those jobs, if you recognize the loans from private banks are not likely to reach predebt crisis levels for years to come, then there is, it seems to us, recognition of a need for foreign investment.

The administration's view is that foreign investment offers vital funds, technology, management skills, access to world markets. We hope Mexico will give further attention to improving the investment climate.

INVESTMENT FUNDING

Funding of investment, of course, is a factor. We welcome ideas and initiatives such as the kind that you've proposed. The administration believes that private investment flows are essential to encouraging investment in the developing countries. Nevertheless, what Mexico does on the investment climate will be the primary factor in determining whether there will be substantial new impetus to expansion of the Mexican economy or, on the contrary, a desultory return to the growth that doesn't really meet Mexico's development needs or its employment needs.

Thank you.

PREPARED STATEMENT

Senator DECONCINI. Thank you very much, Mr. High. Your prepared statement will be inserted at this point in the record.

[The statement follows:]

PREPARED STATEMENT OF GEORGE B. HIGH
DIRECTOR, OFFICE OF MEXICAN AFFAIRS
DEPARTMENT OF STATE

US-Mexico Relations: Trade and Investment

Senator DeConcini, ladies and gentlemen, I am George High, Director of the Office of Mexican Affairs in the State Department. I am pleased to have this opportunity to meet with you here in Phoenix today to discuss some aspects and implications of our trade and investment relations with Mexico in the context of our overall relationship. I'd like to begin by raising with you some general considerations regarding Mexico's situation and our bilateral relationship, and then discuss briefly trade and investment.

General Considerations

Our relations with Mexico are as diverse and complicated as they are with any of our major allies and other trading partners. It is hard to find a department or agency in Washington that does not interact with a counterpart in Mexico. We deal with a wide range of important issues that cover most aspects of our life: Global issues, like population, food, development, migration and peace. Economic issues, such as finance, trade, investment, and fisheries. Cultural matters, for example, the many educational and cultural exchanges. Border issues, including business, bridges

and border crossings, environmental protection and urban development. Law enforcement, from combatting illegal trafficking in narcotics, to customs cooperation, and extradition.

Our relations with Mexico are very good. President de la Madrid has characterized them as mature. That is to say that they are positive and that both countries are engaged in trying to narrow our differences, when we have them, and finding solutions to our problems.

Recognizing the "historical baggage" of our relations, that is, the occasional conflicts and irritations that both countries have experienced at times in the past and that still from time to time affect attitudes on both sides of the border, both our Presidents are committed to reducing frictions, enhancing mutual understanding, and finding solutions. Their personal friendship and rapport are important elements in our bilateral relations. Close personal ties between cabinet members and agency chiefs across the border are important elements of the situation, as well. Several weeks ago Secretary of State Shultz met with Foreign Secretary Sepulveda in Brasilia; they see each other frequently on a wide range of international and binational matters. This week Energy Secretary Labastida has visited Washington to meet with our Energy Secretary Hodel. Treasury Secretary Regan, Commerce Secretary Baldrige, Agriculture Secretary Block, and US Trade Representative Brock meet often with their Mexican counterparts. Our Ambassador in Mexico, John Gavin, is engaged in a broad range of contacts and dialogue, as is the Mexican Ambassador to the United States. Each year our two Congresses

hold an interparliamentary meeting of several days to review matters of concern to them. Right now Congressman Bill Richardson of New Mexico is in Mexico City with a delegation from the Hispanic Caucus. You yourself, Senator DeConcini, are no stranger to Mexico City or to visits by Mexican legislators and executive leaders to Washington. And on the private side, there are innumerable contacts across the border between business, civic, professional, university and other cultural groups.

The point is that because of the depth and breadth of our relations and the importance each country has to the other, there will always be major issues to resolve. That is the experience we have with our friends in the European Community and with Japan. The test of our leadership is whether or not we are willing and able to work at resolving them. For the occasional voice one hears suggesting that our relations with Mexico are bad, I can only say such persons may be looking back in history but not to the realities of today which concern us in Washington and Mexico City and along the border.

For point of reference, let me also reiterate what is long standing United States policy. We want to see a strong, independent, economically developing Mexico. We do not stand to gain from a weak Mexico. All you have to do is look at the decline in our exports to Mexico and new investment in Mexico during the recent economic crisis to see that. Or consider the magnitude of the migration issue, or the fears held by some of the danger posed to Mexico and us by serious instability in Central America. We do benefit greatly from a strong, self-confident Mexico, fully engaged as a major trading partner and playing a broad role in the hemisphere and the world. As I

mentioned, problems we will always have because we are neighbors with a very complex relationship. But they can be and now are the kinds of problems we work on with all our friends. They are part of the reality of living together.

Under the rubric of general considerations, we need to put into context Mexico's present situation and prospects for the future. In 1982-83, Mexico experienced its worst economic crisis since the Great Depression. Gross national product fell by over 6 percent and per capita income by 10 to 15 percent. The impact across the board, and especially to business, the middle class, and labor, has been very severe.

The Mexican government has responded very positively and effectively to this crisis. The economic constraints imposed by the government -- cuts in the budget, reduction of programs and some subsidies, currency devaluation, reduced imports -- have been spread across the society to secure an equitable balance of the burden. The stabilization program required leadership and courage; it also required sacrifice by the Mexican people.

The results of this program have been very positive. Mexican finances have been reordered. Both public and private debt have been stretched out. The confidence bankers have in Mexican leadership is reflected in the results of the recent debt negotiations and the lower interest rate spreads and other improved terms agreed upon. Mexican leadership has been applauded widely for the difficult steps that were taken. And now Mexico is beginning to have the leeway to consider and address long-term, structural problems.

There are some people in Mexico who, having gone through this crisis and suffered severely, remain very pessimistic. And there is a very active cynicism found throughout Mexico that is disconcerting. This contrasts markedly with the government efforts to build confidence and support. What is the outlook then? As bleak as some say? As rosy as some hope? Or somewhere in between?

I've long learned in the Foreign Service the difficulty of projecting the future -- of other countries, as well as my own. Yet, we have to assess the future and take stock. I simply suggest that a certain degree of humility is required in deciding on and presenting the conclusions we reach. Let me simply make several points for the perspective we're dealing with.

-- Americans seem to have a tendency every decade or so of projecting doom and gloom in Mexico. But Mexico has progressed and prospered, and made it through difficult situations.

-- Whenever we Americans talk about Mexican stability, many Mexicans take that as code words for latent American interventionism in Mexican affairs. We have no such intentions or interest.

-- The Mexican government is aware of the continuing difficulty and sensitivity of its situation. Its leaders have repeatedly indicated that progress has been made, but the problems are long-term and much still needs to be done.

-- Supporters of a "domino theory" overlook the strength and flexibility of Mexican institutions.

I do not make light of Mexico's difficulties. Observers need to follow developments closely to understand what is happening. For their part, Mexican officials have made it very clear that they recognize the difficulties they confront. Like these official, we foreigners need to be concerned, supportive and interested, while keeping a sense of balance that comes from an awareness that Mexico has long-standing, proven institutions, which when under pressure in the past have evolved and adjusted to meet the challenge of the times.

Times once again are hard. The situation is difficult. People in Mexico and outside Mexico are concerned. The Mexican government is very much engaged in addressing the situation. I think people do us all a disservice, and one to Mexico as well, when they succumb to pessimism.

What then should we be doing? How can we be helpful? How are our interests best protected?

The answer lies in policies which recognize the economic interdependence of both countries, the United States and Mexico.

From time to time, we in the United States have talked about having a special relationship with Mexico. As neighbors, we necessarily have special relations. But historically, given the asymmetry in our situations, the focus has been to ask what special concessions the US can offer to Mexico.

I don't question that we have to take into account the special circumstances of Mexico's situation, particularly in periods such as this when Mexico is experiencing very difficult times. But our focus in the US must be broader--both in terms of geography and in terms of the evolutions of our economies.

Our relationship with Mexico cannot be based on the assumption of permanent economic asymmetry. The Mexican economy has grown and diversified. And it will continue to do so in the future. Increasingly then, both US and Mexican economic policies must be based on the assumption of mutual interests and responsibilities, on give-and-take from both sides -- the kind of relationship which characterizes major trading partners and sovereign equals.

Secondly, US economic policies, while recognizing the special position of Mexico as our neighbor, must also respond to our regional and world responsibilities. Hence, we must try to maintain coherence between our actions toward Mexico and our broader interests globally and regionally.

Finally, while our resources may look very rich indeed from some perspectives, clearly they are severely limited relative to our overall needs and responsiblites both internationally and domestically.

If you look at our policies and actions within this conceptual framework, I believe reasonable observers will conclude that our economic posture toward Mexico has been very positive indeed.

Trade

Mexico is our third largest trading partner, after Canada and Japan. It is our most important foreign supplier of petroleum. Mexico is very anxious to maintain US markets as wide open as possible to Mexican products so that it can earn the foreign exchange it needs for imports and to make payment on its very substantial external debt, now over $96 billion. The United States is also eager to retain and expand its markets in Mexico, markets severely reduced over the past few years because of the economic crisis. Our exports to Mexico in 1981, when the Mexican economy was overheated, were valued at $17.4 billion. By 1983, our exports had fallen to $9.1 billion. This year, exports from January through August stood at $7.7 billion, a thirty percent increase from the corresponding period in 1983. We understand the reason for the decline from 1981 to 1983. We look forward to expanded trade opportunities as the Mexican economy regains its health.

Mexico frequently criticizes the United Sttes for being protectionist, and protectionist measures raised from time to time in our Congress cause concern to Mexican government and business leaders. But, the fact is that despite pressures here, our markers are the most open in the world. Many categories of Mexican exports to the United States enter free of duty, either because global trade liberalization has eliminated our tariffs or because Mexico is eligible for our Generalized System of Preferences (GSP). I am pleased to note that the Congress recently renewed the GSP for another eight and a half years. I should also note that the renewal legislation is designed to promote more liberal trade and investment regimes in benefitting countries. Mexico is one of

the principal countries to benefit from GSP -- three quarters of a billion dollars in eligible exports to this country in 1983. Additionally, the average rate of duty is low on dutiable items not eligible for GSP. Moreover, non-tariff barriers impede Mexican exports in only limited cases. In fact, total Mexican exports to the US have grown from $14 billion in 1981, to $15.7 billion in 1982, to $16.8 billion in 1983. From January through August 1984, Mexican exports to the US were valued at $12.1 billion. Over half of those exports are in petroleum products, but non-petroleum exports have also expanded in that time-frame.

There has been great concern in Mexico, as you know, over our countervailing duty legislation. This legislation, in the interest of fair and undistorted trade, seeks to offset subsidies accorded to products exported to the US market so that US producers are not disadvantaged. Since Mexico is not a member of the General Agreement on Tariffs and Trade and has not subscribed to the subsides code, it is not entited under US law to the "injury test" in countervailing duties cases. That "test" requires a determination by the US International Trade Commission that a US industry is injured or threatened with injury before a countervailing duty can be levied against subsidized exports to the United States. We have been negotiating with Mexico for several years over the text of a bilateral agreement that would accord Mexico the "injury test" in return for a removal of the subsidies.

We have no overall trade agreement with Mexico. At times observers comment that our trade relations with Mexico are too ad hoc. The suggestion is made that they should be more broadly based and have a more effective mechanism -- such as a

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trade agreement structure -- to help manage our trade relations in good and bad times. We have in fact been discussing the possibility with Mexico of creating a new framework to strengthen our trade relationship. We are prepared to move forward on this matter now.

Whether or not we have a formal trade agreement, it is important to recognize that a very active dialogue has existed for a long time among the managers of our trade relations. A structure for negotiations is already present in the Joint Commission on Commerce and Trade. This JCCT is co-chaired in the United States by the Secretary of Commerce and the US Trade Representative and in Mexico by the Mexican Secretary of Commerce. It has sub-groups, several of which are active and effective; and there are mechanisms for discussion with the private sector.

While mechanisms can be improved upon and used more effectively, the point I want to leave with you is that the structures and contacts are there if there is the necessary will and flexibility on both sides to resolve trade problems. What would be helpful are commonly agreed principles and procedures governing trade and investment.

Investment

United States investment in Mexico is estimated at $4.5 billion, or 68 percent of total foreign investment in the country. The next largest investor is West Germany, which has an estimated $864 million in Mexico.

To round out the picture, foreign investment in Mexico accounts for only about 4 percent of total private investment, and about 2.5 percent of total direct investment if the public sector is included.

When we consider foreign investment, the starting point is recognition that the Government of Mexico determines the rules that apply to foreign investors. Those rules generally require Mexican ownership of at least 51 percent of any enterprise that has foreign investment in it.

Mexico was encouraged by many business interests, in the aftermath of the 1982 economic crisis, to liberalize that requirement. The result has been no change in the law, but statements by Mexican officials indicating sectors in which foreign investment would be welcome, especially in products intended for export - and statements that Mexico would interpret its regulations on ownership and other policies relating on foreign investment liberally.

Mexico's investment climate is made up of many factors. Among the positive ones are the size of the market, the size and capabilities of the work force, the abundance of raw materials, transportation facilities, and Mexico's extensive infrastructure. Other positive factors are the reputation and capabilities of President de la Madrid and his economic team, the efforts of the government and the Mexican people to straighten out the economy, and the success they have had in implementing economic stabilitization policies. Recent divestitures of shares in private companies obtained by the government as a result of the 1982 nationalization of the

domestic banking system are also seen as positive developments. Some procedures in the investment process have been simplified.

On the negative side have been the severe shocks attendant to the economic crisis of 1982 - the nationalization of the banks, the forced conversion of dollar-denominated deposits in Mexican banks to pesos, severe devaluation of the peso in 1982 and the widespread loss of confidence and attendant flight of capital, and concern over what is seen as a trend toward centralization and growing public sector domination of the Mexican economy. There are also heavy bureaucratic controls, and more recently a number of regulations proposed or implemented for industrial sectors where foreign investment is found, such as pharmaceuticals, which many investors see as seriously inhibiting their ability to do business.

There has been very little new investment in Mexico since the 1982 crisis. The in-bond maquiliadoras in the border area are doing very well and growing. Ford and Mexico have agreed upon a new plant at Hermosillo, and ground is about to be broken. Most recently, General Motors is very close to final agreement with Mexico on a joint venture in new truck production facilities. Indeed, as the Mexican economy begins to recover -- its growth is expected to be between one and two percent this year -- it is likely that there will be new investment.

But in all candor I must say that the views we get from investors is generally one of strong ambivalence and caution. They watch closely what is happening with the new regulations

for the pharmaceutical industry, and for the Mexican government's decision on an IBM 100 percent equity investment proposal. Many are telling us that while high Mexican authorities speak of welcoming foreign investors, when they deal in specifics with the bureaucracy they find new or planned restrictions and the delays and opposition they have experienced before. Thus, the picture businessmen receive is one of mixed signals which, unfortunately, do not provide the clear attraction needed in a very competitive world market.

According to the Mexican Secretariat of Finance, the amount of new foreign investment authorized during the first ten months of 1984 was $1.5 billion, including Ford's planned $500 million investment. That is more than double the $683 million authorized during the same period of 1983. But Bank of Mexico figures for the actual investment flows in the first half of 1984 were only about $80 million, compared to $374 million in all of 1983. As a point of reference, new foreign investment in the pre-crisis year of 1981 was almost $1.2 billion. This may reflect the caution which foreign investors are taking toward Mexico. These figures do not include investment in the in-bond industries, which appears to be growing rather rapidly, but for which no statistics are available.

There is no suggestion that Mexico should not maintain national control over foreign investment, which is always a sensitive political issue for any country, including our own. But if we consider Mexico's economic outlook, domestic investment is unlikely to be sufficient to provide employment for the nearly one million people entering the work force each

year. Nor are loans from foreign private banks likely to approach the pre-debt crisis levels for years to come.

The Administration's view is that foreign investment can make a valuable contribution of resources, technology transfer, management skills, and access to world markets which can help major debtor countries such as Mexico work their way out of the debt problem. That is why we hope that Mexico will give further attention to improving its investment climate and to clarifying doubts that persist among investors.

Funding of investment is a factor, as you know, Senator DeConcini. And you yourself have given a good deal of attention to that. We welcome initiatives to consider ways to strengthen private investment flows to Mexico. Nevertheless, the investment climate itself in Mexico will be the primary factor in determining whether or not there is a substantial new impetus to expand the Mexican economy or, if instead, mixed signals result in a desultory return to growth that does not fully meet Mexico's needs or provide the new employment vital to economic growth.

DEPARTMENT OF AGRICULTURE

AGRICULTURAL COUNSELOR, U.S. EMBASSY

STATEMENT OF JOHN MONTEL, AGRICULTURAL COUNSELOR, U.S. EMBASSY IN MEXICO CITY

IMPORTANCE OF AGRICULTURAL TRADE POLICIES WITH MEXICO

Senator DECONCINI. Mr. Montel.

Mr. MONTEL. My name is John Montel, Senator. I'm the counselor for Agricultural Affairs in the Embassy in Mexico City. I have been there for 5 years.

I appreciate this opportunity to discuss the Mexican agricultural economy and most importantly our relationship in trade and other aspects of agriculture.

The relations between the United States agricultural community and Mexico are important not only because of the large volume of two-way trade in agriculture, but also because ongoing veterinary disease control, plant protection, and agricultural research programs have been very beneficial to both countries.

The United States Department of Agriculture has several such cooperative agreements, and I think it's important to note here that the sum total of those agreements between the United States and Mexico are by far the largest in the world. When those programs are fully staffed, there are on the USDA Program over 80 Americans and 220 Mexican nationals. There is no larger program with any other country in the world.

AGRICULTURAL SUPPLY AGREEMENT

As a way of facilitating agricultural trade between the United States and Mexico, we negotiated at Mexico's request an annual agricultural supply agreement which has been in force since 1980. Under the agreement, Mexico agrees to acquire specified minimum quantities of United States agricultural products. The amount specified in this particular year, that is the present year, is 6.1 million tons of various grains, and oilseeds, and tallow. As in previous years, the agreement is nonbinding, though Mexico generally purchases at least the amounts agreed. Whereas the agreement specifies 6.1 million tons this year, we expect them to acquire roughly 8 million tons.

Mexico has been an extremely important market for United States feed grains and oilseeds, and this helps obviously to boost United States agricultural exports in a period of otherwise very slack demand all over the world. It's our No. 1 market for sunflower seed and for sorghum, and Mexico ranks among the top 10 United States corn and sorghum markets nearly every year. Ex-

ports of corn and soybeans to Mexico during the last 5 years have averaged about 3 million and 1 million tons, respectively.

In fiscal year 1984, United States farm exports to Mexico totaled nearly $2 billion, making Mexico the fourth ranked foreign destination for United States farm products. Mexico is our largest single farm export destination in the entire Western Hemisphere.

In fiscal year 1984, United States imports of agricultural products from Mexico reached over $1.5 billion.

MEXICAN IMPORT LICENSING POLICY

Mexico's restrictive and what we consider arbitrary import licensing policy is troublesome to us. I'm beginning a new chapter in the view of our relationships in trade here. We view also restrictive the Mexican Government's requirements that most of the corn, rice, beans, wheat, and nonfat dry milk be imported through a government purchasing agency. This is CONASUPO, which enjoys a monopoly over imports of these basic commodities.

Our trade relationship is not without some problems from the Mexican point of view. These often involve our United States health and sanitary requirements which impinge on Mexico's exports of mainly fruits but some vegetables as well on occasion.

ECONOMIC RECOVERY IN MEXICO

With regard to the economic recovery, reference has been made to the severe economic crisis in 1982 and the subsequent devaluation of the peso. This underlines some of those problems as Mexico sought to restrict imports and expand exports in an effort to rescue the economy and to deal with its massive foreign debt which by late 1983, as some of my colleagues recalled, amounted to some $90 billion.

Exports of United States farm products to Mexico which have reached over $2.4 billion annually in 1980 and 1981 were cut by more than 50 percent to less than $1.2 billion in 1982. The brunt of this decline was suffered by our exports of wheat, corn, sorghum, pulses, and soybeans.

I'm sure you're aware, Senator, that there was a severe drought in Mexico in 1982. This necessitated massive grain shipments from the United States in 1983. Our exports of corn, sorghum, soybeans, and soymeal rose sharply in that year. Total U.S. agricultural exports then reached over $1.9 billion.

EXPORT CREDIT GUARANTEE PROGRAM

But through this period of drought and financial constraints the United States has helped Mexico maintain its agricultural imports through the use of one of our Commodity Credit Corporation export credit programs called GSM-102. This is the Export Credit Guarantee Program. Under this program the CCC guarantees United States banks against nonpayment for any reason by Mexican banks on financing extended against irrevocable letters of credit. On the other end, the Mexican Government guarantees that its financial institutions will pay against those letters of credit.

In fiscal year 1984, we continued this support, albeit with a reduced export credit sales program amounting to $790 million in guarantees. Of that amount, more than $200 million was not used because as Mexico's economy recovers, CONASUPO, the Government import monopoly, has preferred the flexibility of buying with cash.

DECLINE IN MEAT AND LIVESTOCK DEMAND

With regard to the current situation, as the drought ended, Mexican grain production recovered in 1983 and 1984. Domestic feed grain supplies increased but the continuing Mexican economic recession caused sluggish demand for meat and livestock products, and this in turn created cost squeezes on the livestock sector. Therefore, Mexico's feed grain imports from the United States dropped back in 1984. There is some improvement in the Mexican livestock sector, and this is likely to contribute to increases in the United States sales of soybeans and other oilseeds to Mexico this year.

The above-average rainfall this year has contributed to improvements in pastures, reservoir levels are up, and the outlook is quite favorable for Mexico's 1985 crops. Unless crops fall short of current expectations, or if the Mexican economy grows much more rapidly than expected, Mexican livestock product demand, and thus livestock-feed demand, in 1985 will not likely be large enough to require substantial increases in imports of United States grains and oilseeds in 1985.

UNITED STATES MARKET DEVELOPMENT COOPERATORS

In the context of agricultural trade relations with Mexico, I would be remiss not to mention the work of our United States market development cooperators.

The Foreign Agricultural Service provides funds on a cost-sharing basis to nonprofit U.S. commodity organizations to promote export sales of their own commodities worldwide.

Three of these cooperators have established offices in Mexico. They are the American Soybean Association, U.S. Wheat Associates, and the U.S. Feed Grains Counsel.

In 1985, 11 other cooperators will also conduct promotion activities in Mexico and they work with our office in the Embassy.

In summary, Senator, we view the economic health of Mexico as vital to our continued export trade to that market. We believe that United States export credit programs applied to shipments of agricultural inputs such as speed, breeding animals, and semen can contribute significantly to the recovery of Mexico's agriculture.

COOPERATION IN TECHNICAL AREAS

Along with these efforts in trade, we look for continuing good cooperation in several technical areas that contribute to the well-being of agriculture in both our countries.

We have worked in plant and animal protection to eradicate pests and disease through joint research and facilities to carry out activities such as the production of sterile flies to combat several

diseases. The sterile fly plan uses uranium imported from the International Atomic Energy Association in Vienna, Austria. These are just a few examples of the common interest that both of our countries have in activities which can ultimately give a boost to trade by eliminating pests and disease risk and which can also save the agricultural economies of our two countries many dollars in crops or animals spared.

This concludes my statements, Mr. Chairman. I would be very happy to respond to questions.

PREPARED STATEMENT

Senator DECONCINI. Thank you, Mr. Montel, very much. We will insert your prepared statement at this point in the record.

[The statement follows:]

PREPARED STATEMENT OF JOHN E. MONTEL
U.S. AGRICULTURAL COUNSELOR TO MEXICO

Mr. Chairman, members of the committee, I appreciate the opportunity to discuss the Mexican agricultural economy and, most important, our relationships in trade and other aspects of agriculture.

The agricultural community's relations with Mexico are important not only because of the large volume of two-way trade in agriculture, but also because ongoing veterinary disease control, plant protection, and agricultural research programs have become very beneficial to both countries.

The U.S. Department of Agriculture has several cooperative agreements with Mexico, and a large number of disease control technical specialists and researchers stationed in Mexico. In each of these areas USDA has strong working relationships with the Mexican Government, characterized by joint program operations, frequent consultations, and exchanges of information. The private and academic sectors have similarly strong relations with Mexican agriculture in each of these areas.

TWO-WAY TRADE FLOWS:

As a way of facilitating agricultural trade between the United States and Mexico, an annual supply agreement has been in force since 1980. Under the agreement, Mexico agrees to acquire specified minimum quantities of U.S. agricultural products. The current annual trade agreement on agriculture calls for the United States to supply 6.1 million tons of corn, sorghum, soybeans, sunflowerseed, cottonseed and tallow. As in previous years, the pact is non-binding though Mexico generally purchases the agreed amounts.

Mexico has been a very important market for U.S. feed grains and oilseeds in recent years, helping boost U.S. agricultural exports in a period of otherwise slack demand. It is our number one export market for

both sunflowerseed and sorghum. Sunflowerseed exports to Mexico have averaged about 500,000 tons over the past 3 years and sorghum exports have fluctuated between 500,000 and 3.2 million tons. In addition, Mexico ranks among the top ten U.S. corn and soybean markets nearly every season. Exports of corn and soybeans to Mexico during the last five years have averaged about 3 million tons and 1 million tons, respectively.

This is not a one-way street. Two-way agricultural trade with Mexico totaled over three billion dollars in fiscal year 1984, with large movements in each direction, evidence of significant interdependence and of mutual benefits from our trading relationship.

U.S. farm exports to Mexico in fiscal year 1984 totaled nearly two billion dollars, making Mexico the fourth ranked foreign destination for U.S. farm products and our largest single farm export destination in the American Hemisphere. U.S. imports of agricultural products from Mexico reached over $1.5 billion in FY 1984, exceeded in dollar value only by trade from Brazil and Canada.

Here is summary data showing the composition of this trade in fiscal year 1984.

U.S. Agricultural Trade with Mexico: (FY 1984)

Major U.S. Exports	($ millions)	Major U.S. Imports	($ millions)
Corn	433	Coffee	353
Sorghum	378	Tomatoes	171
Soybeans	409	Cattle	119
Non-fat Dry Milk	40	Fresh cucumbers	11
Cattle hides	65	Fresh peppers	78
Total	1,966	Total	1,334

No trade relationship of this size is without some frictions and this one is no exception. From our point of view, a large part of our problem stems from the fact that Mexico is not a member of the General Agreement on Tariffs and Trade (GATT), applying trade policies that do not conform with the GATT.

Mexico's restrictive, and what we consider arbitrary, import licensing policy is troublesome to us. And we also view as restrictive the Mexican Government's requirement that most corn, rice, beans, wheat and nonfat dry milk be imported through a government purchasing agent, which is CONASUPO, the National Basic Commodities Supply Organization. However, we have on the whole developed a good relationship with CONASUPO, which has been our major partner in the annual commodity supply agreements referred to earlier.

Our trade relationship is also not without some problems from the Mexican point of view. These often involve U.S. health and sanitary requirements--an area where through technical assistance we do our utmost to help Mexico comply.

ECONOMIC RECOVERY: HOPED FOR SOLUTION:

Mexico's severe economic crisis in 1982 and the subsequent devaluation of the peso underlined some of these problems as Mexico sought to restrict imports and expand exports in an effort to rescue the economy and deal with its massive foreign debt (some $90 billion by late 1983).

Exports of U.S. farm products to Mexico, which had reached over $2.4 billion annually in 1980 and 1981, were cut by more than 50 percent to less than $1.2 billion in 1982. Wheat, corn, sorghum, pulses, and soybeans, our major export commodities to Mexico, suffered the brunt of this decline.

A severe drought in Mexico in 1982 necessitated massive grain shipments from the United States in 1983. U.S. exports of corn, sorghum, soybeans and soymeal rose sharply in that year and total U.S. agricultural exports reached over $1.9 billion in 1983.

During its period of drought and financial constraints, we have helped Mexico maintain its agricultural imports from the United States through the use of our GSM-102 Export Credit Guarantee Program. Under that program the Commodity Credit Corporation guarantees U.S. banks

against nonpayment for any reason by Mexican banks on financing extended against irrevocable letters of credit.

When Mexico's economic crisis struck in the summer of 1982, it was clear that Mexican importers could no longer be sure of the availability of foreign exchange to pay for imports. In order to help Mexico maintain its vitally needed food imports, CCC allocated $312 million in guarantees for the remainder of fiscal year 1982. We followed that up on September 17 by announcing availability of $1 billion in guarantees for fiscal 1983. Although the Mexican Government had never participated in the program they were able to move quickly to coordinate buying arrangements through CONASUPO, and sales were successfully made for about all of the $1.3 billion available.

In fiscal 1984 we continued our support with $790 million in guarantees. Of that amount more than $200 million was not used; as Mexico's economy recovers, CONASUPO has preferred the flexibility of buying with cash. Most of Mexico's imports under the program have been for the basic commodities: feed grains, oilseeds, oils and oilseeds meals. We have also sold small amounts of tallow and wheat, but we were unable to support sales of commodities imported by the Mexican private sector. In arranging the use of available guarantees the Mexican Government gave priority to the basic imports needed to feed its people.

We are prepared to extend a significant amount of guarantee coverage to Mexico in the current fiscal year but are waiting for the Mexican Government to let us know the kinds of commodities and amounts they need to import using credit.

CURRENT SITUATION:

With the end of the drought, Mexican grain production recovered in 1983 and 1984. Domestic feedgrain supplies increased, but the continuing Mexican economic recession caused sluggish domestic demand for meat and livestock products, and thus cost squeezes on the livestock sector. Therefore feedgrain imports from the United States have dropped back in

1984. The Mexican cattle, poultry and hog sectors are currently improving, contributing to increases in U.S. shipments of soybeans and other oilseeds to Mexico this year.

Above normal rainfall this season has contributed to improvements in pastures and good reservoir water levels, yielding a favorable outlook for Mexico's 1985 crops. Unless crops fall short of current expectations, and/or the Mexican economy grows much more rapidly than expected, Mexican livestock product demand, and thus livestock feed demand in 1985 will not likely be large enough to require substantial increases in imports of U.S. grains and oilseeds in 1985.

In the longer term, the eventual recovery of the Mexican economy can contribute to increased demand for feed imports and could allow Mexico to relax its restrictions on other U.S. farm exports.

In discussing our agricultural trade relationships with Mexico, I would be remiss not to mention the work of our U.S. market development cooperators.

The Foreign Agricultural Service provides funds on a cost-sharing basis to nonprofit U.S. commodity organizations to promote export sales of their own commodity worldwide.

Three of these cooperators have established offices in Mexico. They are the American Soybean Association, U.S. Wheat Associates, and the U.S. Feed Grains Council.

Eleven other cooperators will also conduct promotion activities in Mexico in 1985. They are the American Quarter Horse Association, Brown Swiss Cattle Breeders Association, Holstein-Friesian Association of America, National Association of Animal Breeders, National Association of Swine Records, National Cottonseed Products Association, National Renderers Association, National Sunflower Association, Rice Council for Market Development, U.S. Beef Breeds Council, and U.S. Meat Export Federation.

We view the economic health of Mexico as vital to our continued

export trade to that market. We believe that U.S. export credit programs applied to shipments of agricultural inputs such as seed, breeding animals, and semen can contribute significantly to the recovery of Mexico's agriculture.

Along with these efforts in trade, we look for continuing good cooperation in several technical areas that contribute to the well-being of agriculture in both our countries.

We have worked in both animal and plant protection to eradicate pests and disease through joint research and facilities to carry out activities such as sterile fly production.

As a result we have pushed the screwworm barrier to the Southern-most part of Mexico and hope to push it further south in Central America. We are working on a Medfly eradication program with Mexico and Guatemala through the same method.

We also have been cooperating with Mexico and other Central American countries to stop the northward movement of the Africanized Honey Bee and have provided assistance to deal with citrus canker in recent years.

I cite them as evidence of a common interest in activities which ultimately can give a boost to trade by eliminating pest and disease risks and which can also save the agricultural economies of our two countries many dollars in crops or animals spared.

This concludes my statement, Mr. Chairman. I will be glad to respond to questions.

General Questioning of Departmental Witnesses

FLIGHT OF CAPITAL FROM MEXICO

Senator DeConcini. I do have a number of questions. Due to time we won't be able to get all of them in the record here, but I may submit some, if you would be so kind to answer them in the record.

I am very interested, Mr. Conrow, in the question of capital flight that Mexico has experienced. What is the estimated amount of assets held abroad? Does anybody have any such guesses?

Mr. Conrow. No, we don't, sir. In fact, last time we tried to do that we got ourselves in trouble. If you don't mind, I'll submit something for the record on that.

Senator DeConcini. That would be helpful.

[The information follows:]

Mexican Assets Held Abroad

Mexican deposits in U.S. banks are on the order of $13 billion at end 1984. Mexican direct investment (at least 10 per cent ownership in an investment venture) in the United States is around $300 million at end 1983.

EFFORTS OF MEXICAN GOVERNMENT TO ATTRACT CAPITAL BACK

Do you know what the Mexican Government is doing to attract that capital back?

Mr. Conrow. I think, Senator, it would be in the context of their overall economic adjustment program. The exchange rate adjustments that we've talked about, their attempt to deal with the deficit problem that they have, the whole attempt to stabilize the financial sector of their country and then hopefully, as we've all indicated in varying degrees in our statements, improving the environment in Mexico for investment back into the country.

I don't think in terms of capital flight it will return to Mexico until that environment has indeed been improved. That is the reason in my statement I stressed somewhat critically the fact that the Mexicans in my view have not come anywhere near what they ought to be doing in that area and in my opinion they're not going to get the capital returning to Mexico until that environment has improved. I believe that's fundamental.

Senator DeConcini. Is there anything you think we can do or are we contemplating doing anything to assist to slow down that capital flight, at least to the United States, or is it considered that if it is going, we might as well have it come here?

Mr. Conrow. We certainly don't look at it from that perspective. I do believe that the answer certainly lies in Mexico. They themselves have to provide the environment that's attractive to investors both in terms of capital flight leaving Mexico and new capital coming from United States investors who are interested in activity in Mexico.

I believe from the standpoint of the United States Government the approach that we take is one of talking to the Mexicans continuously about this at all levels including the Secretary of State level.

I know in terms of congressional interest you yourself have been to Mexico, and they have raised that issue.

The relationship between the United States and Mexico is one of so many interlinkages at so many different levels that we all have to continue to press the Mexicans to look at what is in their long-term interest.

MEXICAN RELIANCE ON WORLD CAPITAL MARKETS BORROWING

In my own view, if you look at the financial situation up ahead of us, the ability of Mexico to effect sustained economic growth based on borrowings in the world capital markets from commercial banks is simply not a tenable proposition any longer. They cannot do it. The levels of borrowings they've had in the past will not return. The alternative is for equity investment in Mexico. That is what we've been talking to the Mexicans about. Basically the Mexicans respond favorably. In terms of words, they say they understand, they realize and they are committed to doing so but I think as we all know and I think through your hearings and the panels today that will delve into it in greater detail, when you get down to the practicality as a businessman trying to look at opportunity in Mexico you run into bottlenecks.

DISCLOSURE OF FOREIGN INVESTMENTS

Senator DECONCINI. Do you think that it's counterproductive or useless for us to attempt to do anything to discourage capital flight, like requiring disclosures of investments made by foreigners, so that it would be known by that foreign government? Has the Treasury given any thought on that or how does that hit you?

Mr. CONROW. It's difficult. My position is that of Deputy Assistant Secretary of Treasury for Developing Nations. I have this problem all over the world right now from the standpoint of the Philippines to Central America and the Caribbean, and not only Mexico. It is a continuing problem that we have to look at. We don't have an answer. To be very candid about it, there's not an answer.

Senator DECONCINI. What about disclosures of foreign investment in this country? Would that help in your opinion?

Mr. CONROW. It might, but I doubt it in any serious way. If you're holding assets in Mexico and you feel that your savings that you've accumulated are in danger, you're going to place them in a safer place. If the environment is not stable in Mexico or in these other countries, you will find alternatives for it, whether there's disclosure or not. I think that's a marginal factor but I don't think in the long run it's a significant one.

Senator DECONCINI. What you're saying is if it's going to fly, it's going to go.

Mr. CONROW. It's going to go.

Senator DECONCINI. If it doesn't go here, it may go to Great Britain or some other country.

Mr. CONROW. That's right.

ALTERNATIVES TO CONTROLLING CAPITAL FLIGHT

Senator DECONCINI. Is it possible that the establishment of a foundation or some entity that would have some ties with our Government for development in Mexico could be an attraction to any of that returning capital? Can you see the construction of some investment that would go into Mexico that might bring this capital back, maybe not my idea but any such idea?

Mr. CONROW. If one first postulates that the investment climate in Mexico is going to change, if you start with the basis that that environment is going to change in the coming years, I think a lot of different vehicles then become possible.

I don't believe, though, that if the current environment that we see today in Mexico and after this crisis that this current environment remains for the next few years, that any particular vehicle will produce the sorts of goals or objectives that you have or that we have.

I think the only way one can overcome a negative environment on the Mexican side is to basically put in place a U.S. Government guarantee so an investor knows that even though the environment might not look attractive, he's got Uncle Sam to bail him out. As long as he knows someone will take care of his investment, he's prepared to do it. I think that's what we have to focus on. If the underlying environment is not attractive and if the U.S. Government is going to be asked to provide that guarantee, people will go, but I think it's the wrong answer.

Senator DECONCINI. You think it's the wrong approach?

Mr. CONROW. I think it's the wrong answer.

Senator DECONCINI. You don't think it's worth trying to do that?

Mr. CONROW. Again, I think the greater effort ought to be made on changing the environment in Mexico and then we have a——

CREATION OF ENTITY TO PROVIDE CAPITAL

Senator DECONCINI. I agree with you there. Assuming that happens or it doesn't, and let's assume for discussion purposes that it goes along like it is now, slight to moderate improvement, is it to our advantage to attempt to create such an entity that might provide capital even if the Government of this country would guarantee the investment? Wouldn't that help that environment in Mexico if there were capital investments coming back into the country or is the climate not ready for that?

Mr. CONROW. It would depend on how Mexico negotiated that with us.

From my own position we have negotiated with a number of governments now a series of investment programs designed somewhat along the same line. In the World Bank, we have a new capital increase for the International Finance Corporation [IFC], which is an equity investment program which also provides some loans. In the Inter-American Development Bank we created, the Inter-American Investment Corporation which is designed to do loans and equity in Latin America and the Caribbean and in which Mexico is a participant. We've also been trying to create a multinational investment guarantee agency which is designed along the same lines. With that particular initiative we've had difficulty from the Mexico Gov-

ernment, Brazil, and other Latin American countries due to their historical concerns about foreign investment. They have put up a lot of red flags to that effort. Right now my feeling is that there are a number of international programs that we've been pursuing with the developing countries, Latin America in particular, some of which they've been responding to, others of which they have not.

Whether or not another program that is purposely bilateral would be helpful I think we would have to look at that in the context of the broader issues, the budget deficit, and the whole idea of new entities and new expenditures on the Government side.

EFFECT OF HIGH U.S. INTEREST RATES ON FLIGHT OF CAPITAL

Senator DECONCINI. How important do you think the interest rates in this country are, the fact that we've been record high even though they're down over what they were 2 or 4 years ago? Has that been an attraction to capital flight or would it have flown anyway?

Mr. CONROW. I think it certainly was an enticement. My own view is that that particular element is itself a draw all over the world, capital coming to the United States with our high interest rates.

RELAXING OF NATIONALISM PRACTICE IN MEXICO

Senator DECONCINI. Mr. Conrow and Mr. High, in the waning days of the presidency of Lopez Portillo there was a great expropriation of the banks and other financial institutions. At the same time I understand that that really expropriated many shares in private industry there as well, much of the private sector. Has much been done, if anything, to return some of that ownership to the private sector and how much of that has occurred? Do any of you know or care to comment? Mr. Montel?

Mr. MONTEL. Senator, over 80 percent I understand has been returned or sold back to the private sector.

Senator DECONCINI. Of those nationalizations that came about?

Mr. MONTEL. Yes, sir.

Senator DECONCINI. Do any of you have any idea now what percentage of the economy in Mexico is in the private sector? Is that a——

Mr. HIGH. When you get three statisticians together, it's like three lawyers and three economists, they come up with three pictures. I would guess 70, 75 percent is State-owned and 20 to 25 percent is private.

SLOW GROWTH IN PRIVATE SECTOR

Senator DECONCINI. It's been reported to me in some studies that before Mr. Lopez Portillo was President it was about 50 percent private sector. After he left, it was only 20 percent. That's what we're down to now. That includes Mexican officials particularly from the State of Sonora that I've met up here a couple of times that are scared about what's going to happen. If there's been a return of much of that stock and much of that ownership and——

Mr. HIGH. Some of that doesn't mean new money in Mexico because what people have done is take the money they got out of the nationalization of the banks to pay for these private shares. There has been no——

Senator DECONCINI. There's been no growth in the private sector of any substance?

Mr. MONTEL. That's correct.

MEXICAN PURCHASE OF UNITED STATES MILITARY ARMAMENTS

Senator DECONCINI. Thank you.

Mr. High, regarding our foreign relations with Mexico, we see that in the military sense they have made a few purchases from the United States. They bought some F-5's and a couple of Navy ships. I don't know if they were able to pay for them or not. Do we enter into any negotiations with Mexico or have we or are we in the area of military sales?

Mr. HIGH. We don't, Senator, no. Mexico as a matter of policy has wanted to diversify its sources of supply so it buys from Europe and the United States and anywhere else it can. The last big purchase was, as you've suggested, the airplanes. There is no sales program of credit sales or otherwise between the United States and Mexico.

LOW-COST MILITARY ASSISTANCE

Senator DECONCINI. Are we considering offering any military assistance at low cost——

Mr. HIGH. No, sir.

Senator DECONCINI [continuing]. To Mexico.

Mr. HIGH. No, sir.

Senator DECONCINI. What would be our policy if they should ask for that type of military assistance in the sense of financing it through our foreign assistance legislation?

Mr. HIGH. I think the first point is Mexico is very unlikely to ask for it.

Second, if they did, our funding is so committed in terms of other priority areas in Latin America and the Middle East and other places that it would not be available.

We have been very keen on establishing a closer relationship between the United States military and the Mexican military because it's been rather distant traditionally. It has been more one of limited amounts, very limited amounts of training and visits back and forth.

STABILITY OF MEXICAN POLITICAL SITUATION

Senator DECONCINI. Mr. High, with what appears to be a growing perhaps disenchantment with the Revolution Party of the President in Mexico and perhaps the National Action Party gaining support at least in off-year elections, we've seen it in this country, too, and it doesn't mean much any more, but would you consider the Mexican political situation or environment as stable as it was 6 years ago or more stable or can you give us any observation of what you think is happening?

Mr. HIGH. I think in terms of the Mexican political environment, it is probably more effervescent, if I can borrow that term, now than it was 6 years ago. The PRI has lost some of its support, as perhaps any party would in most countries after having gone through the economic problems that they have. Of course, as you've mentioned, PAN and a couple of the other opposition parties have won some elections, particularly last year. That was new on the Mexican scene. It's interesting that over the last 2 months there have been several elections in the States of Mexico and Yucatan and one or two others and the PRI has done quite well. There have been some allegations in the press that ballot boxes were stuffed, but I don't know that that's shown. The fact is that people looking at most of the data conclude that the PRI has done surprisingly well in elections in the last couple of months.

Senator DECONCINI. Do you anticipate any major changes there politically, or would you anticipate it going along the same?

Mr. HIGH. No major changes.

Senator DECONCINI. Gentlemen, I have a number of other questions. I would like to ask that you remain there, if you can. As we go through these witnesses, if you need to get up for one reason or another, I understand. If you have the time to be with us as we go through the other witnesses, I would appreciate it.

Business and Industry Representative

NONDEPARTMENTAL WITNESSES

KAIBAB INDUSTRIES

STATEMENT OF A. MILTON WHITING, CHAIRMAN OF THE BOARD, KAIBAB INDUSTRIES

PROFILE OF KAIBAB INDUSTRIES

Senator DECONCINI. Our next witness is Mr. Whiting, the Chairman of the Board of Kaibab Industries. If you'll come forward.

Gentlemen, you can stay right there if you like. If you're comfortable doing that. If you need to roam around, I understand that. Perhaps we might call you now and then.

Mr. Whiting, thank you for being here with us. We will put your full statement in the record and wish you would please proceed.

Mr. WHITING. OK. I appreciate the opportunity to testify. I congratulate the Senator and his staff for arranging for this type of dialog to take place.

Maybe I should first preface my remarks with a brief profile on the company I represent, which is a Phoenix headquartered company, Kaibab Industries, with its largest segment being involved in forest products, manufacturing in northern Arizona and southern Utah.

DEVELOPMENT OF BACKHAUL LOADS FROM MEXICO

A short number of years ago as the oil prices escalated it became apparent that our company needed to develop backhauls primarily for the lumber trucks that were hauling products out of Payson, AZ. It became imperative that we develop a backhaul load in order to remain competitive because those areas are very remote, to say the least, and it was at that time that we developed the strategy of looking at imports from Mexico along the northern border primarily because Texas was our largest consuming market, followed by Arizona and California of our own lumber products.

As we investigated trade with Mexico and dealt primarily and initially with forest products from Mexico, we then branched out into some other building material categories and commodity items. And it is for that benefit that I would like to share my comments and remarks with you today.

We had a keen interest concerning the border between our State and Mexico.

TWO-WAY BORDER TRADE IN BUILDING MATERIALS

We think that Arizona can play a key role in improving the understanding of what might take place in U.S. trade policy, and we

encourage two-way trade across the border, and as we've seen examples, especially in the Phoenix area, even this past several months there has been occasions when Phoenix has been the largest builder of homes in the United States. That being the case, and a company such as ours that are highly dependent on housing starts and construction, it is with no small concern that we look at all factors concerning building material products.

COMPETITIVE QUALITY OF MEXICAN PRODUCTS

As our company became exposed and involved in truly developing a working relationship with our Mexican partners, we found that the products from Mexico were competitive. They were well accepted. They were well manufactured. We were not afraid to put our stamp on Mexican products and our reputation on the line. The Mexican products have been of high quality. They've been available and they have been marketable at fair prices.

CEMENT IMPORTS

Maybe as a case in point, more recently we have become more involved in the importing of Mexican cement through our El Paso facilities, and we will be opening a terminal on the Southern Pacific properties in Chandler at the end of the month. This terminal was financed half by our company and half by the Mexican producer.

I would like to make a comment also that as we sell Mexican cement in Arizona and surrounding States that over one-third of the value of that product is in the form of transportation, all of which is done by American carriers, so this was a great stimulus and benefit for the transportation industry, both trucking and railroad, into the Phoenix area and all of Arizona and the surrounding areas.

At the present time we're importing around 12,000 tons of cement per month from northern Mexico, and as we finish the terminal I mentioned we will be at a 15,000-ton-per-month level which is over 500 truckloads a month. Sounds like a lot. This would be less than 10 percent of the usage of cement in Arizona.

So that you have a frame of reference, the business of importing foreign products has created jobs domestically and transportation and marketing effort domestically. It's created investment by Mexican partners right here in Maricopa County. We're involved in the importing of other building products, marble and tile, forest products, plywood, lumber, particle board, some steel products. We have found them to be good. We recommend them highly.

We feel that we have a moral obligation, and even maybe more than that, to help establish a job based in northern Mexico. We know of the illegal alien problems. We know of all the problems that run along this vast border that we're trying to police. I can't think of anything we can do that would be more intelligent to help our Mexican neighbors stabilize their workforce and create their jobs and now even our company is looking at exporting products from the United States to Mexico.

EXPORTING A TWO-WAY STREET

We find our Mexican partners have finally seen that this needs to be a two-way street. It can't be products flowing across the border one way. We have products they need. We have found there has been a great deal of concern at the Washington level by Congress and some of the bureaus concerning imported products. We feel that these products must meet the test on subsidy and duty and so forth.

There should not be unfair competition, but the Federal funding cuts that played havoc with us when we tried to get several hundred truckloads of cement across the border in El Paso, and they've cut back the staff, and they only keep the gate open 8 hours a day. You ought to wait in that line sometime. We have a concern over some of the budget cuts.

Even more than that, it's a social and economic benefit to both countries that outweigh the negatives that we feel strongly about. We have found our Mexican partners to be ethical, intelligent business people. Reliable.

As I say, we feel that it will be a two-way street. We feel that products can flow both ways. We feel that this common border is going to be here forever. It's not only to our political benefit but also our eocnomic benefit to see that it is protected and used and studied, and we encourage hearings such as this one, and we hope that other Senators and Congressmen will take the time to learn the truth about the opportunities and how we can cope with the problems. If they'll involve the private sector, like you're doing, and let the business people be part of it, I think that we can work out some of the political problems.

I paraphrased a lot of my written statement. I apologize, Senator.

Senator DECONCINI. Thank you, Mr. Whiting, for doing that.

Mr. WHITING. I would appreciate the opportunity and would try to answer any questions.

EFFECT OF U.S. BUDGET CUTS

Senator DECONCINI. You talk about budget cuts. You're talking about the Customs Service and INS and border inspections. I guess what you're saying is the same thing that we heard with Mr. Nelson from the INS down on the border just a few days ago that those cuts are really minimal as relating to the whole deficit, and there are literally millions of dollars of Mexican money wanting to come here and be spent.

Mr. Whiting. I missed the testimony but I agree with it. To cut one person out that could keep several thousands or hundreds of thousands of dollars of products flowing doesn't seem to be cost effective.

Senator DECONCINI. Particularly with the balance of trade as it is.

Mr. WHITING. Yes.

LEGISLATION PENALIZING CEMENT IMPORTS

Senator DECONCINI. I have to give Mr. Nelson some credit, and I would like to do it right here. I received yesterday a letter that in Nogales he is assigning four new people down there to help that problem and maybe that will also occur.

During the 98th Congress, Mr. Whiting, the provision was added to the omnibus trade bill which would have penalized import of Mexican cement on the grounds that the Mexican producers enjoy an unfair advantage because of their access to low-cost fuel and labor. The provision was eventually dropped. You and I talked about it one time I remember. What's your industry's reaction to such legislation?

Mr. WHITING. I don't have the—I would be glad to make available a statement, the policy statement of the particular cement companies that were more seriously impacted. It was not an even-handed approach to the application of the countervailing duties. The information that I have read would support their position that they do not have a subsidy arrangement as far as the cost of fuel and so forth goes, and I guess I would like the opportunity after having visited with their Washington counsel and our Washington office and reviewed it that we would like to be able to supply the information that would relate to that.

IMPORT DUTIES ON FOREST PRODUCTS

Senator DECONCINI. I would like to have that for the record and we'll leave it open.

We also had some discussions sometime about forest products. What is the status now of import duties on some of the forest products that you bring in?

Mr. WHITING. Each line of forest products falls in a different category.

Senator DECONCINI. Plywood was one.

50-PERCENT RULE

Mr. WHITING. Plywood is one. Of course, Mexico is not a member of GATT. Maybe it should have been, but I won't get into all that, but the tariffs that apply to plywood are triggered by the 50-percent rule and that we discussed with you before——

Senator DECONCINI. Do you want to explain the 50-percent rule for the record here?

Mr. WHITING. Well, up until now the regulations were that if over 50 percent of an imported product that came in from developing countries came from a single company, that product then in the ensuing year a 20-percent tariff would be imposed.

Senator DECONCINI. Has that happened to some of those forest products, including plywood?

Mr. WHITING. Well, what the Mexican producers have tried to do is control the level of shipments so that they did not exceed the 50-percent level. The problem is there's no other countries that manufacture softwood sanded pine plywood except Mexico, so it's hard to stay under 50 percent. So far it's kind of been in-a-year, out-a-year type of thing, which is a disaster on the marketplace.

Senator DECONCINI. On the plywood it's unrealistic?

Mr. WHITING. Plywood doesn't make sense. It should be categorized or grouped with other competing species so it does what was intended. The other products, such as particle board, moldings, and even lumber are not that severely tariffed, taxed at the present time.

LEVERAGE IN TRADE NEGOTIATIONS WITH MEXICO

Senator DECONCINI. If you were the U.S. Trade Representative, and I wish you were——

Mr. WHITING. I'd shoot myself.

Senator DECONCINI. I would hate to wish that on a good friend. I wish you were. We would have some relief for copper and other things.

If you were tasked with negotiating improvement with the United States-Mexico border trade situation, what would you focus on? What leverage would you attempt to use to get a better bargaining arrangement with Mexico?

Mr. WHITING. Well, I got in on the tail end of some of the questions you were asking and so on concerning the percentage of private ownership. I think, and I hope I'm saying this right and don't get in trouble saying it, but I think whatever concessions the United States Government might make in developing and maintaining the two-way flow of trade and permission of exporting products from Mexico to the United States should be coupled, and I talked with you about this in Washington when our Mexican colleagues were there, should be coupled with some requirements that the private sector be strengthened and that the return of some of these facilities be—that there be a definite program that would leave the banks out, that these other manufacturing and industrial facilities be returned to the private sector and that the philosophy of Mexico wouldn't be counted out as far as the free enterprise system goes. And also that Mexico cannot be restrictive on the free flow of goods from the United States to Mexico. We have certain areas that they feel are holy and that can't be. I talked with them about that and they're gradually softening on this so it can't just be a flow of goods one way across the border. I think that should be part of the——

Senator DECONCINI. One of the things you would do is encourage the Mexican Government to sell some of the nationalized industries, as Great Britain and other countries have done, back into the private sector?

Mr. WHITING. I might use a stronger word than encourage but maybe——

Senator DECONCINI. Insist?

Mr. WHITING. Yes, I would strongly encourage.

RETURN OF NATIONALIZED INDUSTRY TO PRIVATE SECTOR

Senator DECONCINI. What encouragement would you use?

Mr. WHITING. Well, I think we need some oversight effort from the United States that would set up some goals and that there would be some—there would be some written commitment on which of these industries were nationalized that shouldn't have

been. We don't import from those industries that are nationalized because they're not reliable. We don't find them to be—that they talk our language so the products we're bringing in are from the nonnationalized companies.

Senator DECONCINI. Your company?

Mr. WHITING. My company. I'm talking about Kaibab. That's just our company.

We feel they would do better if run by the private sector.

Senator DECONCINI. I guess you're really saying that if Mexico wanted to get its house in order the best thing to do is return to the private sector?

Mr. WHITING. Absolutely.

PREPARED STATEMENT

Senator DECONCINI. Thank you, Mr. Whiting. I appreciate your testimony. Your prepared statement will be inserted in the record at this point.

[The statement follows:]

PREPARED STATEMENT OF A. MILTON WHITING

CHAIRMAN AND PRESIDENT

KAIBAB INDUSTRIES

U.S.-BORDER STATES, SUCH AS ARIZONA, ARE ESPECIALLY SENSITIVE TO U.S.-MEXICO RELATIONS, BUT REST OF COUNTRY AND U.S. INDUSTRY HAVE LITTLE UNDERSTANDING AND LIMITED INFORMATION. IT IS OUR HOPE THAT HEARINGS SUCH AS THIS WILL MOVE OTHER MEMBERS OF CONGRESS TO TAKE AN INTEREST IN LEARNING OF THE BENEFITS OF INTERNATIONAL TRADE BETWEEN THE TWO COUNTRIES. U.S. TRADE POLICY ENCOURAGES BUSINESS ACROSS THE BORDER, BUT POLITICAL CONSIDERATIONS HAVE GENERATED UNCERTAINTY AND PROBLEMS. WOULD LIKE TO USE KAIBAB'S EXPERIENCE TO ILLUSTRATE.

KAIBAB INDUSTRIES' ORIGINAL BUSINESS OF FOREST PRODUCTS WAS VERY DEPENDENT ON INTEREST-SENSITIVE HOUSING INDUSTRY. TO SMOOTH CYCLICAL NATURE OF THAT BUSINESS, THE COMPANY DIVERSIFIED INTO OTHER INDUSTRIES INCLUDING DISTRIBUTING MEXICAN-MADE PRODUCTS SUCH AS STEEL, CEMENT, CERAMIC TILE, ETC.

IN RECENT YEARS, ECONOMIC GROWTH IN SUN-BELT STATES HAS SIGNIFICANTLY INCREASED DEMAND FOR BUILDING PRODUCTS, OVERTAKING THE REGION'S MANUFACTURING CAPACITY. (COULD USE NUMBERS ON GROWTH OF HOUSING STARTS OR COMMERCIAL CONSTRUCTION IN REGION FROM 1970-1980 OR SO, OR NUMBER OF NEW RESIDENTS. COULD POSSIBLY INCLUDE EMPLOYMENT FIGURES FOR CONSTRUCTION NUMBERS.)

KAIBAB FOUND MEXICAN PRODUCTS TO BE OF HIGH QUALITY, READILY AVAILABLE, AT MARKETABLE PRICES. SO WE BEGAN TO IMPORT AND DISTRIBUTE.

FOR EXAMPLE, WE STARTED IMPORTING CEMENT THROUGH EL PASO IN LATE 1983. THIS PRODUCT IS TRANSPORTED FROM EL PASO TO ARIZONA VIA AMERICAN RAIL AND TRUCH TRANSPORTATION. OUR IMPORTS OF CEMENT HAVE REACHED A LEVEL OF 12,000 TONS PER MONTH EQUALING APPROXIMATELY 420 TRUCKS PER MONTH. WE EXPECT THIS VOLUME TO INCREASE TO APPROXIMATELY 15,000 TONS PER MONTH BUT YET WILL BE LESS THAN 10% OF THE STATES CONSUMPTION. THIS BUSINESS HAS CREATED JOBS IN IMPORTING, TRANSPORTATION, MARKETING AND CONSTRUCTION.

WE HAVE GIVEN OUR CUSTOMERS QUALITY PRODUCT, GOOD SERVICE AND AT A PRICE THAT HAS HELPED TO CONTROL THE COSTS OF RESIDENTIAL AND COMMERCIAL STRUCTURES. ACCORDING TO THE NATIONAL ASSOCIATION OF HOME BUILDERS, THE STABILITY OF CONSTRUCTION MATERIALS PRICES, INCLUDING THOSE FOR CEMENT, HAS BEEN AN UNUSUAL AND POSITIVE DEVELOPMENT IN THE ECONOMIC RECOVERY.

WE ARE IMPORTING BUILDING PRODUCTS FROM THE NORTHERN STATES OF MEXICO

WHICH MUST LOOK TO THE SOUTHWEST U.S. FOR MARKET OPPORTUNITIES BECAUSE OF THEIR GEOGRAPHICAL DISTANCE FROM URBAN AREAS AND EXPORT FACILITIES. TRANSPORTING LOW VALUE-TO-WEIGHT RATIO CEMENT TO THE COAST FOR EXPORT MAKES CEMENT NON-COMPETITIVE EXCEPT IN U.S. MARKETS. RESULTS OF DEVELOPING THESE MARKETS ARE NEW JOBS, STABILIZED EMPLOYMENT, AND GROWTH OF LOCAL ECONOMIES IN MEXICO. IF THIS SUCCESS CAN BE REPEATED THROUGHOUT THAT COUNTRY, IT WILL REGENERATE DEMAND FOR U.S. GOODS.

PROGRESS HAS NOT BEEN WITHOUT PROBLEMS, HOWEVER. WE HAVE EXPERIENCED LEGISLATIVE THREATS OF HIGHER DUTY ON CEMENT, AND REDEFINING NATURAL RESOURCES AS A SUBSIDY. FEDERAL FUNDING CUTS HAVE CAUSED CUSTOMS SERVICE PERSONNEL CURTAILMENTS, CREATING HAVOC AT BORDER CROSSINGS.

THE LIMITED HOURS (8 HOURS) IN WHICH OUR TRUCKS CAN CROSS THE BORDER FROM CIUDAD JUAREZ TO EL PASO HAS SEVERELY RESTRAINED OUR ABILITY TO MAXIMIZE THE USE OF THE EXPENSIVE EQUIPMENT.

ECONOMIC AND SOCIAL BENEFITS TO BOTH COUNTRIES OUTWEIGH NEGATIVES IN OUR OPINION. KAIBAB HAS FOUND MEXICAN INDUSTRIALISTS HARDWORKING AND KNOWLEDGEABLE BUSINESS PARTNERS. TRADE TO MEXICO'S LATIN AMERICAN NEIGHBORS HAS BEEN DISRUPTED DUE TO THE UNREST IN THOSE COUNTRIES.

MEXICO NEEDS OUR MARKETS TO BUILD STRONG BASIC INDUSTRIES WHICH CAN EXPAND THEIR EXPORTING CAPABILITIES AND BECOME SELF-SUFFICIENT. THE U.S. NEEDS MEXICO'S PRODUCTS TO SUPPLY THE REGION'S DEMAND AND CONTINUE DOMESTIC INDUSTRY'S ABILITY TO REBOUND FROM THE PAST 4 YEARS OF ECONOMIC RECESSION. WE HOPE THAT U.S. DOMESTIC AND TRADE POLICIES WILL NOT HINDER MEXICO'S COMMERCIAL TRADING RELATIONSHIP WITH THE U.S.A.

THANK YOU FOR THE OPPORTUNITY TO PRESENT THIS TESTIMONY. I WILL BE GLAD TO ANSWER ANY QUESTIONS YOU MAY HAVE.

Border Trade Panel

Western Mexico Vegetable Distributors' Association

STATEMENT OF GEORGE URIBE, VICE PRESIDENT, WESTERN MEXICO VEGETABLE DISTRIBUTORS' ASSOCIATION

GRASSROOTS ASSISTANCE IN TRADE RELATIONS AND POLICY

Senator DeConcini. We'll now go to the Border Trade Panel. Mr. George Uribe, vice president, Western Mexico Vegetable Distributors, is with us and Mr. William Joffroy, vice president of William Joffroy Customs House Brokers.

Is Mr. Acosta or Arthur Doan here? They were also to be part of this panel. If someone sees them come in, please ask them to join us.

Mr. Uribe. Thank you, Senator DeConcini.

I certainly welcome the opportunity to participate as a panelist for your Subcommittee on Foreign Operations hearings.

I most certainly want to commend you on this approach as it will give the people at the grassroots level an opportunity to have what I think is vital input on what might be used to shape United States-Mexico trade relations and policy.

It has been that more often than not bilateral trade agreements are entered into by both countries and as a result are based on recommendations which are made by some individual who is sitting in Washington, DC or Mexico City who has either never been to the border or has absolutely no idea what it is to live in a community, in a border community, and more important how severely we are affected by bilateral trade agreements. These individuals use facts and figures which are themselves cold and certainly do not take into account the real people who live on the border with real and human feelings whose lives are ultimately affected on a day-to-day basis.

PRESIDENT JOHNSON'S EXECUTIVE ORDER ON REORGANIZATION PLAN 1

Let me give you a prime example of this. In 1964 Lyndon Baines Johnson, through Executive order, invoked his Reorganization Plan 1 which contained four provisions which adversely affected United States-Mexico trade relations. I'm going to comment on one of these and that it bears out emphatically what I have just stated. Said plan called for the moving of the U.S. Customs Arizona District Office to the San Diego, CA district. We were advised that a team from the Treasury Department came to Nogales and probably decided that because of the size of the community there was no need for a district office in Nogales. They did not realize, nor did they bother to ask, that Nogales, as an inland port, handles twice the volume of business as the port of San Diego and a much greater amount than El Paso, TX. Second only to the port at Laredo. I'm happy to say that thanks to the cooperation of yourself and our other national legislators we won that battle. Had we not been alert to the disastrous economic effect that this would have had on our community and the produce industry in particular, we probably would be out of business now.

We handle a perishable agricultural commodity which requires decisions be made on the spot and not have to wait for a district office somewhere else to make a decision as to whether or not a commodity can or cannot come into the country.

I believe I do not have to elaborate on the economic effects that our industry has on our community and our State.

UNITED STATES-MEXICO TRADE RELATIONS RELATING TO PRODUCE INDUSTRY

Let me talk about United States-Mexico trade relations as it concerns our industry. The biggest problems affecting the produce industry are trade barriers on the part of both countries. Mexico on the one part has protectionist policies which severely affect our industry in that if an item such as equipment, seed, fertilizers, et cetera, is supposedly available in Mexico, it cannot be imported into Mexico. Unfortunately, more often than not, the aforementioned items are not available in Mexico.

On the other hand, in the United States we have duties and tariffs which of themselves have the same effect as trade barriers. We also have marketing orders on certain commodities, in our case tomatoes, and more recently grapes. These marketing orders or agreements which are adopted by certain areas affect imports. To me these are nothing more than a legal way that domestic producers of a crop, like I have just mentioned, have to avoid prosecution under the antitrust laws and specifically restraint of trade in that they get together and restrict the free flow of those goods into the marketplace and all under the sanctions of the Secretary of Agriculture, which again, unfortunately, affect imports.

HAWLEY-SMOOT TARIFF ACT

In 1930 the Congress of the United States adopted the tariff proposal, the Hawley-Smoot Tariff Act, which went down in history as a symbol of insensitivity to the public interest. Some of its provisions are still with us today, and without realizing it, the American consumer or family pays from $3 to $500 a year as hidden subsidies, import quotas, and other trade restrictions.

In my opinion we should exert every effort to attain the free flow of goods and services across the United States-Mexico border.

What then might be a possible solution? Get Mexico to join GATT, General Agreement on Tariffs and Trade, which might help to alleviate some of Mexico's protectionist policies. Do away with our marketing orders in the United States which will allow for the free flow of goods and services into the marketplace

BALANCE OF TRADE BETWEEN UNITED STATES AND MEXICO

In my position quite often I'm asked the question why should we have Mexican tomatoes and other products on the United States marketplace. Very simply Mexico cannot buy from the United States unless Mexico can sell to the United States. I'm sure that you're aware that Mexico is the third ranked customer of the United States, and I know that you're aware of the fact that the balance of payments is in favor of the United States. I think that

these two reasons alone are enough to justify Mexican products on the United States market.

I could elaborate a lot further on the multitude of American products which are found in the Mexican marketplace.

LOCATION OF AMERICAN COUNSEL'S OFFICE

I was not going to touch on another aspect of Mr. Johnson's reorganization plan, but after thinking it over, I think that it is critical to the border community and more specifically the American businessman in that this provision called for the moving of the American consul's offices into the interior of Mexico to the State capital, in our case Hermosillo, Sonora. How does this affect trade? Very simply, I have come to the border for one reason or another, and while there I might decide that I would like to cross the border to buy some personal or business items. Unless I have all, and I mean all, of the necessary documents, I will not be able to get a simple permit to visit the United States. I will have to go back to Hermosillo, the capital, 187 miles south of the border in order to take care of whatever problem I may have. This happens on a daily basis, and I must say that that leaves a very bad taste in the mouths of our would-be customers or buyers.

There is no doubt in my mind that most of the problems which we have in this area are as a direct result of the American consul's office not being along the border where they belong. We were told that the purpose of the move was for the State Department to have a better sounding board for the political climate of the individual State.

To my knowledge one of the primary functions of the American consul's office in a foreign country is to aid American citizens and to issue documents which are vital to crossing the United States-Mexico border in our case.

We would do very well to adopt the same attitude as our Mexican counterpart, who welcomes American tourists within a certain limit of the border without any documentation at all, and if you desire to travel into the interior of Mexico, they will issue a tourist permit free of charge for whatever length of time you want.

As a Mexican citizen try to come into the United States. I believe that it is most unfortunate that the attitude of the United States officials is that every Mexican who comes to the border is trying to get across to stay. I would suggest to you that if I had any intentions of coming across the border as an illegal, I most certainly would not come to the border inspection station and ask for a permit when there are hundreds of miles of open country along the United States-Mexico border where I can cross.

In our industry we have legitimate farmers who need to cross the border to visit their distributors for accounting or liquidations. God bless them if they do not have again all of the necessary documents. I would suggest a free commercial zone along the border for the free flow of goods and services the way Mexico does.

CASH FLOW OF UNITED STATES DOLLARS TO MEXICO

Let me talk a little bit about the most critical problem with which we are faced, and this is brought about by the severe eco-

nomic crisis facing Mexico. This is with the return of divisas—meaning dollars—to Mexico by Mexican growers. The Mexican Government has control of export permits and, second, with the nationalization of the financial institutions, a grower is required to obtain a release from the financial institutions stating that the grower obligates himself to return *x* number of dollars to Mexico before Mexican customs will issue his export declaration. On top of this, these dollars will be kept by the bank and the grower will be paid in pesos at a controlled rate which varies considerably from that of the open market.

It seems to me that the United States being a principal customer of Mexican products—mainly oil and gas, could or should exercise as much influence as possible in order to achieve some relief with regard to Mexico's protectionist policies—and as a principal participant in the International Monetary Fund, the United States should attempt to bring about the return of the financial institutions to private enterprise.

I think that Mexico's economic crisis is going to be with us for quite some time to come, especially when you consider Mexico's inflation rate which is running at about 80 percent, its unemployment at about 60 percent, Mexico's deficit of $89 billion, balance-of-payments problems, and the high cost of living. I don't think that there's a better way that we could help our good neighbors to the south than by encouraging expanded trade relations.

I also have to be realistic enough to say that this cannot be a one-way street. I'm sure we could come to some kind of an agreement which is going to be beneficial to both countries.

Again, Senator, I commend you for your effort in this regard.

PREPARED STATEMENT

Senator DECONCINI. Thank you, Mr. Uribe. Stay right there. I have a couple of questions. We will insert your prepared statement in the record.

[The statement follows:]

PREPARED STATEMENT OF GEORGE H. URIBE

EXECUTIVE VICE-PRESIDENT

WEST MEXICO VEGETABLE DISTRIBUTORS ASSOCIATION

I certainly welcomed the oportunity to participate as a panelist for your Sub-Committee on Foreign operations hearing. AND I MOST CERTAINLY want to commend you on this approach as it will give people at the grassroots level the oportunity to have what I think is vital imput on what might be used to shape U.S. - Mexican Trade Relations or Policy.

This has been a pet peeve of mine for many years .... in that more often than not....Bilateral trade agreements are entered into by both countires which are as a result off or are based on recommendations which are made by some individual who is sitting in Washington D.C. or Mexico City who has either never been to the Border ...or has absolutely no idea of what it is to live in the Border Community and more important how severly we are affected by said Bi-Lateral Trade Agreements. These individuals use facts and figures which of themselves are Cold and certainly do not take into account the real people who live on the Border with real and human feelings whoe's lives are ultimately affected on a day to day basis....

Let me give you a prime example of this.....In 1964 Lynden Bains Johnson thru Executive order invoked his Re-Organization Plan #,1. this contained four provisions which adversely affected U.S. - Mexico Trade Relations. I am going to comment on one of these in that it bears out emphatically what I have just stated.....Said plan called for the moving of the U.S. Customs Arizona District office to the San Diego Calif. District. We were advised that a team from the Treasury Department came through Nogales and they probably decided that because of the size of the community there was no need for a District Office in Nogales...What they did not realize (nor did they bother to ask) was that Nogales as an In-Land Port handled twice the volume of business as that of San Diego and a much

greater amount than that of El Paso, Texas.... Second onlu to the Port at Laredo..... I'm happy to say that thanks to the cooperation of our National Legislators ...we won that battle...Had we not been alert to the disasterous economic effect this would have had on our community and the produce industry in perticular .. we probably would have been out of business by now. We handle a perishable agricultural commodity which requires that decissions be made on the spot and not have to wait for the district office somewhere(s else to make a dacission as to whether or not a commodity can or cannot enter the country....
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Let me talk about U.S.-Mexico Trade relations as it comcerns our Industry....The biggest problem affecting the Produce Industry are trade Barriers on the part of both Countries.... Mexico on the one hand has Protectionest Policies which severly affect our industry. in that if an item such as Machinery , equipment , seed, fertilizer, etc. is supposedly available in Mexico it just simply cannot be imported into Mexico....Unfortunately ... more often than not the affore mentioned items are not available in Mexico.....
On the other hand In the United States we have Duties and Tariffs which of themselveshave the same effect as Trade Barriers... We also have Marketing Orders for certain commodities...in our case Tomatoes and more rescently Grapes... These Marketing orders or agreements which are adopted by certain areasaffect imports..... To me ... these are nothing more than a legal way that Domestic Producers of the crops that I have just mentioned have to avoid prosecution under the Anti-Trust Laws and specifically restraint of trade in that they get together and restrict the free flow of those goods into the Market place... and all under the sanction of the Secretary of Agriculture...which again ultimately affect imports.....

In 1930 the Congress of the United States adopted a Tariff proposal the Hawley-Smoot Tariff Act which went down in History as a Symbol of Insensativity to the Public Interest, some of its provisions are still with us today and without realizing it the American Consumer or family pays from three to five hundred dollars a year as hidden subsidies - import quoatas or other trade ristictions..... IN MY OPINION .. we should exert every effort to attain the free flow of goods and services across the U.S.-Mexico Border.....

What then might be a possible solution????? Get Mexico to Join G.A.T.T. (General Agreement on Tariffs & Trade) which might help to aliviate some of Mexico's protectionist Policies.... Do away with Marketing Orders in the United States which would allow for the free flow of goods into the market place.....

In my postion....Quite often I am asked the question...why should we have Mexican Tomatoes and other products in the U.S. Market place?????

very simply Mexicocannot buy from the United States unless Mexico can sell to the United States..... Did you know that Mexico is the Third ranked customer of the United States .....Did you know that the Balance of Payments is in favor of the United States.....I think that these two reasons alone are enough to justify Mexican products on the U.S. Market and I could elaborate a lot further on this on the multitude of U. S. products which are found on the market place and it runs the gammit from soup to nuts.....

I was not going to toudh on another aspect of Johnsons Re-Organization Plan 1 but after thinking it over I think that it is critical to the Border community and more specficially the American Businessman...and this is the provision which called for the moving of the American Counsul offices to the interior of Mexico to the State Capitols in our case to

Hermosillo Sonora Mexico.....How does this affect trade ??????? Very simply ....I may have come to the Border for one reason or another ... and while there I might decide that I would like to cross the Border to buy some personal or business items..... Unless I have all .. . and I mean a ll of the necessary documents I will not be able to get a simple permit to visit the United States..... I will have to go back to Hermosillo Sonora the C$_{a}$pitol ——187 miles south of the Border in order to take care of or get whatever problem I have taken care off This happens on a daily basis ..... and I must say that this leaves a very bad taste in the mouths of our would be customers or buyers..... There is no doubt in my mind that most of the problems which we have in this area are as a direct result of the American Counsuls office's not being at ehe Border ....Where they B$_{e}$long..... We were told that the pru$_{p}$ose of the move was for the S$_{t}$ate Department to have a better sounding Board of the political climate of the individual state... To my knowledge one of the primary functions of the American Counsul's office in a foreign co$_{u}$ntry is to aid American Citizens and to issue documents which are vital to crossing the U.S.- Mexico Border.... We would do very well to adopt the same attitude of our Mexican counterpart who welcome American Tourists within a certain limit of the Border without any documentation at all..... and if you desire to travel into the interior of Mexico they will issue a Tourist Permit free of charge for whatever length of time you want..... As a Mexican Citizan... try to come into the United States....I believe that it is motst unfortunate that the attiétude of the U. S. officials is that every Mexican who comes to the Border is trying to get across to stay. I would suggest to you that if I had any intentions of comming across the Border as an Illegal ...I most certainly would not come to the Border inspection Station when there are hundreds of miles of open country along the entire U. S. Mexican Border where I can cross....

In our industry we have legitimate farmers who need to cross the Border to visit their Distributors for accounting or liquidations.... God Bless them if they do not have ...again all of the necessary documents... I would suggest a free Commercail Zone at the Border for the free flow of goods and services the way that Mexico Does.

Now let me talk about the most critical problem with which we are faced and this is brought about by the severe economic cricis facing Mexico... and this is with the return of the Divisas (Meaning Dollars) to Mexico by Mexican Growers..... The Mexican Government has control of all Export Permits and second with the Nationaliza tion of the Financial institutions a grower is required to obtain a release from the financial instution stating that the grower obligates himself to return X number of Dollars to Mexico before Mexican Customs will issue his export declaration... on top of this ... these dollars will be kept by the bank and the grower will be paid in pesos at a controlled rate which varies considerably from that of the open market.....

It seems to me that the United States being the principal customes of Mexican products ...mainly Oil and Gas. could or should exercise as much influence as possible in order to achieve some relief wiht regard to Mexicos protectionist policies .... And as a principal partitipant in the Internationa Monetary Fund the United States could and Should attempt to bring about the return of the Financial institutions to private enterprise.

I think that Mexicos economic crisis is going to be with us for quite some time to come especially when you consider Mexicos inflation rate which is running at about 80 o/o its unemployment at about 60 o/o Withe Mexicos deficit of 89 billion dollars balance of payments problem and the high cost of living.... I dont think that there is a better way that we could help our godd neighbor to the South than by encourageing

expandéd trade relation.... I aleo have to be realistic enough to say that this can not be a one way street... but I am sure that we can come to some kind of agreement which is going to be bendficial to both..... Again ... I commend you Senator DeConcini on your effort in this regard....

WILLIAM F. JOFFROY CUSTOM HOUSE BROKERS, INC.

STATEMENT OF WILLIAM F. JOFFROY, JR., VICE PRESIDENT, WILLIAM F. JOFFROY CUSTOM HOUSE BROKERS, INC.

INDUSTRY ACTIVITIES

Senator DECONCINI. Mr. Joffroy.

Mr. JOFFROY. Thank you, Senator DeConcini, for giving me this opportunity to address your subcommittee this afternoon. I always welcome the opportunity to speak with Government officials, especially when those of us in the field are sometimes the last to know the decisions that are undertaken regarding our industries.

Our industry in particular is that of the customs brokerage industry in which we act as agents for importers and exporters. We are licensed by the Treasury Department to do so. Our responsibilities are twofold. One is to provide service to importers and exporters in transacting the customs business, and the other responsibility we have is to protect the revenue of the United States.

We have day-to-day contact with the people that are actually moving goods back and forth across the United States-Mexico border and have a hands-on ability to understand their day-to-day problems in dealing with both the Mexican Government and the United States Government.

GENERALIZED SYSTEM OF PREFERENCES

Before we talk about problems, however, I always like to talk about the positive aspects of doing business between our two countries. One area that should be taken more advantage of is the Generalized System of Preferences, as was noted earlier today. GSP has been extended for 8½ more years. This gives the opportunity for Mexican exports to increase by the mere fact that they are allowed duty-free treatment upon entry into the United States provided that certain requirements are fulfilled, as well as supporting documents.

In our opinion, GSP has not been fully taken advantage of by American importers doing business with Mexico. I believe that can be attributed to a lack of education on the part of the American businessman. GSP is designed to encourage exports from Mexico, and the United States industries that are taking advantage of the Generalized System of Preferences are really having a competitive edge in their industries.

MEXICAN-PRODUCED FRUITS AND VEGETABLES

Nogales happens to be the largest port of entry in the United States, if not the world, of fresh fruits and vegetables. And these fresh fruits and vegetables are being produced in Mexico. There's up to 400 to 600 trucks of produce crossing our border.

Most recently U.S. Customs has entered into a program that may force the offloading of fresh produce at the Customs compound for the inspection of those vehicles and the product to determine whether or not illegal drugs are being smuggled on those trucks. We feel very strongly that there has to be control over the smuggling of drugs into the United States. We also feel that the Government should take a more realistic view as to the liability involved in offloading produce at the U.S. Custom compound. For example, the Custom brokers that are working in Nogales all have crews that assist U.S. Customs in inspecting the products that are being imported, but they are not experts in offloading perishable products. When you have a market on cucumbers of $20 a crate, and you drop a pallet of those cucumbers, we've got problems.

IMPROVED COMMUNICATION WITH GOVERNMENT OFFICIALS

We would like to have a better line of communication with our Government officials. We feel that while some of their ideas are very good, they're not taking another view as to what the results may be to the importing industry. For example, when the idea of inspecting the produce trucks was first entertained, we found out about it. I say we—our industry—through some of the people that we have working at the Customs compound. We were not informed by U.S. Customs until they had decided they were going to implement this system. This is a trend in doing business internationally, not just along the border, with regard to U.S. Customs relations. Decisions are made at higher places, and those of us that are in the field have to find a way to adjust.

FLOW OF CARGO THROUGH PORTS OF ENTRY

On the positive end, U.S. Customs has improved its ability to expedite the flow of cargo through the ports of entry. For example, through the Accept Program we are not able to determine whether or not a Customs inspection will be performed at the time the merchandise actually enters the United States. If the article is a low-risk article, chances are it will not be inspected and can go right through the border to the destination much quicker.

Customs now is automated, which allows those of us in the industry that are automated to have direct communications with U.S. Customs and allows the importers to have a much better service provided for them both by the Government and those service industries that are doing business with them.

The conversations I've had with people in Mexico regarding trade between our two countries, and the conversations are often had because I do a lot of traveling down there. Mexico needs to promote more exports. There are a lot of products in Mexico that will help—not solve—but will help the deficit that they have today.

One of the problems that we see is very simple. People understanding people. Whenever we enter into a business transaction we have to understand what each of us needs, what we want so that we both win.

If you travel to various sectors around northern Mexico, you can hear stories, "Well the gringos did it to us, they screwed us." Well, that may or may not be true.

There is an area that has to be addressed, and that is if the two countries are going to expand their business relations, which we all are here for and hope that this will happen, then the people that are involved in those transactions have to understand their methods of doing business and this has a lot to do with educating people.

Again, these types of hearings I think are very helpful because those of us that are working internationally day to day have a real view of what is going on along the border. For businessmen to understand each other there is also the requirement for the two governments to understand each other.

A couple of years ago there was going to be or there was a program implemented whereby the U.S. Government would report documentation of products entering Mexico under the inbond program. This has become a farce. It's not working.

MAQUILIADORAS PROGRAM

There was another program that would expedite the clearance of shipments that are being assembled under the Maquiliadoras Program. This would allow products to leave the plant, go straight to the border, present the export documents, and be imported into the United States without any delays. Again, this has been a farce. It's not working. The plants are still required to fill out documents that have to go to the United States-Mexican compound, then they have to make another stop at the border before they enter the United States.

These problems must be addressed on the local level. If the idea is created in Mexico City or Washington, then there should also be representation from the areas that are going to be directly affected because they will have a realistic point of view from those people working there.

Thank you very much for this opportunity. I will be very happy to answer any questions.

Senator DECONCINI. Thank you, Mr. Joffroy.

CREATION OF BORDER ZONE

Mr. High, if I could ask you a question raised by Mr. Uribe. He talked about a border zone where there would be free flow of people who have legitimate business. Is that something the State Department would be involved in or is that INS or would it be——

Mr HIGH. I think that's Department of Commerce, and I suppose people like INS would focus on it, too.

Senator DECONCINI. Has the State Department looked at that form a foreign policy point of view at all, particularly as to Canada or as to Mexico?

Mr. HIGH. We've talked about those things with Canada. I'm not so sure but what they don't exist, a couple along the Canadian border. The matter——

Senator DECONCINI. Can you find that out or where would I find that out? Would I find that out from the Commerce Department?

Mr. HIGH. From Commerce.

Senator DECONCINI. I'll make an inquiry.

Mr. HIGH. It has been raised informally with Mexico, very informally at meetings. We haven't gotten any kind of positive response out of Mexico at all. I think there would be a degree of enthusiasm to look at it on our side.

FLOOD OF ALIENS AND DRUGS CLOUD ISSUE FOR LEGITIMATE BUSINESS

Senator DECONCINI. Because of the undocumented alien flood from our southern border and the drug smuggling, there seems to be a different attitude, and maybe justifiably, but it certainly is damaging when it is applied to the legitimate Mexican business or individual who wants to come over and spend money.

The hearings we held down in Nogales just about a month ago with Mr. Nelson certainly demonstrated a lot of attitudes on the part of INS at least as reported by American citizens of feeling that all Mexicans that are coming across are really not welcome, and they're doing something wrong. That is demonstrated here that that is not the case. I wanted to see who would be involved in any such negotiations.

TWIN PLANT ACTIVITIES IN BORDER AREAS

Thank you, Mr. Uribe. Let me ask you about a couple of questions that are a little bit different than your expertise and maybe Mr. Joffroy can help. The twin plant activities, as you know, is when United States companies set up plants near the border in Mexico for assembling and manufacturing of products. Mexico allows duty-free imports of the raw materials and the companies post a bond to assure the products won't be sold in Mexico. When the products are returned to the United States for distribution, the U.S. Government assesses a duty only on the value that has been added. Generally this consists of the labor cost. In 1983 there were 585 twin plants in Mexico employing 125,000 workers. What is your evaluation of the twin plant activities with regards to the benefit both as to Mexico and as to the United States?

Mr. URIBE. I think this is probably one of the most important measures which has been adopted by both countries which will be of mutual benefit, and I will elaborate to the extent that, first of all, that, yes, it has generated tremendous employment in Mexico, which really they are in dire need of.

I can remember having been very specifically involved in 1963 when we had the first plant in Nogales which was the Phoenix Motorola plant and the unions screamed and hollered bloody murder that they were going to run away with plans, and they were going to be out of business. As it turned out, I think within a short period of time as a result of the production that was coming out of the Nogales Sonora plant they increased employment by 1,500 here in the Phoenix plant. That in inself seemed to put a squash to a lot of

the runaway plans. I think it's a tremendous program. Maybe perhaps we ought to be looking for more programs of this type in order to help Mexico.

EXPANSION OF TWIN PLANT ACTIVITIES

Senator DECONCINI. My next question: Has it reached its peak? Could it be expanded do you think in your own judgment?

Mr. URIBE. Hard question to answer. All depends on how much we're getting from abroad, from other countries.

MAQUILIADORAS INDUSTRY

Mr. JOFFROY. I would like to interject. The Maquiliadoras industry has over the years become better understood by both governments. Ten years ago one of the provisions of the tariff schedules provides that prefabricated articles that are manufactured in the United States and exported ready for assembly are allowed a duty exemption on their return to the United States and also operations incidential to assembly have created many, many new decisions in the law regarding this particular area of the tariff. As a result more and more products have been exported to Mexico for assembly. It has created more jobs, and as a result attracted more companies to do business along the border.

NEW INDUSTRY DEVELOPMENT IN CIUDAD OBREGON

There is a problem along the border today in that many of the cities are now saturated, and there has been a problem with turnover amongst the employees. As a result the State of Sonora specifically has embarked on a very aggressive program to develop its interior industrial parks. For example, Ciudad Obregon is the city that is now being targeted for new industry to be developed. We've been working very closely with the developers in Ciudad Obregon for this program. There's some advantages. One, the availability of labor is much better down there. No. 2, you can ship both by truck and by air. Air Mexico serves Ciudad Obregon on a daily basis. Of course, proximity to Mexico has been a great attraction for the American companies that have set up their plants there. It's a lot easier to fly 3 hours to Tucson and drive down to Nogales than to fly 18 hours to Hong Kong.

The labor situation in Mexico is such that most of it is concentrated in the larger cities. It is the intent of the Government to spread this population out to outlying areas and Ciudad Obregon is a very good example of this type of development.

Senator DECONCINI. Thank you.

MODERNIZING CUSTOMS PROCEDURES RELATING TO DRUG PROBLEM

Mr. Conrow, if I could ask you a question. Based on some of the testimony here, and I am going to send it to Treasury, we got some suggestions of modernizing or expediting the Customs procedures with full awareness of the need to scrutinize for the drug problem. Where does that emanate from? Does that emanate from the Secretary's office or from the Commissioner of Customs? Where would the input come to get more modernization and more technology to

advance the better flow and less disruption of the legitimate commercial trade?

Mr. CONROW. The practical answer is the Commissioner of Customs would be, but obviously he does report to the Secretary of the Treasury, so if there's a final decision in the case of budgetary questions and allocation of resources it would go to Secretary Regan in the end.

Senator DECONCINI. It seems clear to me that something could be done in that area to modernize it. I don't want to leave any impressions that they're not willing to consider it, but I want to at least express it to someone from Treasury here. Hopefully that would be looked at. It has benefits and would be advantageous.

Mr. CONROW. I'll be happy to share it with my colleagues.

Senator DECONCINI. I intend to take the testimony from these two witnesses and send it to the Secretary's office, if you would be kind enough to deliver it there.

Mr. CONROW. Will do.

INSPECTIONS TO CURB DRUG FLOW FROM MEXICO

Mr. URIBE. I would like to take the opportunity to thank you for your efforts so far. Unfortunately we feel very strongly that it is a very simple matter that the inspection—and we are all for whatever measures the United States Customs, the Treasury Department want to invoke in an attempt to stop the flow of drugs into our country, which incidentally I should elaborate that in last year's record there were some 45,000 car-lot equivalents which crossed the United States-Mexico border and there were only three incidents.

All we are asking for as an institution is that the inspection be done in a place that it is economically feasible to both parties concerned. We're talking about the individual warehouses where we have the personnel and the equipment to adequately take care of the problem. The facilities, the compound facilities at the U.S. Customs dock in Nogales are just not adequate for what I am told is going to be the volume of inspections that are to take place, anywhere from 5 to 10 trucks a day, which could very severely restrict the flow of the merchandise, perishable commodity to the marketplace.

PERSONNEL PROBLEMS AT PORT OF NOGALES

Senator DECONCINI. Do you find also a shortage of personnel?

Mr. URIBE. This, as I understand, is the response from the officer in charge of the port of Nogales that he is understaffed; that if he had four more men he could do the job. If I remember right, and I wish I had my facts and figures with me here, there is a precedent that has already been established. They are doing this in other areas. Specifically in the area of shrimp. They are allowing the shrimp to be transported to the warehouse, and they conduct their inspection. Why can't we have the inspection of our fruits and vegetables done at the warehouse?

Senator DECONCINI. I don't want to put you on the spot, George. When we were in Nogales during those last hearings, the business community there were not unanimous but certainly said they would

come up with the funds to hire two or three more people on the border there who would grant cards for people to come across because it's such good business for them. Maybe you want to consider that with your association. I realize that practically that can't happen. It is an encouragement. I think it was to Mr. Nelson and might be to Commissioner Van Robb if indeed the offer was made that this is so important that the business community feels that they would be glad to raise a few dollars for one or two inspectors.

Mr. URIBE. I think it is most unfortunate because we generate 35 million dollars' worth of duties to the port of Nogales in a 6-month period. When it goes in a general fund, they have a heck of a time getting that money back to Nogales to help us where they have the problem.

Senator DECONCINI. George, I'll tell the Commissioner that as generous as those business people may be as to the INS officials checking those cards coming across that the produce people feel like they've paid their share.

Mr. URIBE. Thank you.

MERCHANDISE INSPECTION AT IMPORTER'S PREMISES

Mr. JOFFROY. Senator, there is a great deal of concern over what George has been discussing in our industry. We are in favor of sitting down with U.S. Customs and finding solutions to this problem. There are provisions in the law that allow for merchandise to be inspected at the importer's premises, and at the same time I believe our industry is more than willing to participate in discussions so that everybody comes out ahead, particularly Customs. They're very concerned about the safety of the inspectors going over to these warehouses. I think again if we all sat down and discussed this, we could find a solution that would be good for both parties.

Senator DECONCINI. I didn't mean to put you on the spot. I was interested in a reaction from the city business people in Nogales of a willingness because it was so good for their benefit to even pay some of the cost, and quite frankly I think it made an impression on the head commissioner of INS that it just made good sense. As I said, he has allocated four people there, and we are working on the Customs people.

Mr. JOFFROY. Might not be a bad idea to invite the Commissioner in April when there are 600 trucks crossing.

Senator DECONCINI. Thank you very much, gentlemen.

Investment Panel

VALLEY NATIONAL BANK

STATEMENT OF WILL RAPP, VICE PRESIDENT, VALLEY NATIONAL BANK

INTRODUCTION OF PANEL

Our next panel consists of Mr. Jerry Ladman, director, Center for Latin American Studies; Mr. Will Rapp, vice president, Valley National Bank; and Mr. Vernon Penner, a Phoenix attorney.

Gentlemen, if you need to move on, I understand. I appreciate your being here. It's helpful. You've been very kind to stay with us. Gentlemen, thank you for your tolerance and patience here.

Gentlemen, your full statements will be put in the record. Let's start with Mr. Rapp.

MEXICAN ECONOMY

Mr. RAPP. Senator, I thank you for the opportunity of being here today. I hope my own comments could add to the discussion. I've been very interested in hearing the comments of the gentlemen who have preceded me.

Mexico is one of the world's most prominent examples of rapid economic growth. For over four decades it maintained an annual growth rate of more than 6 percent, and its productive capacity is now the ninth largest in the world.

The worst economic crisis in its history struck Mexico 2 years ago. During 1982, gross domestic product fell for the first time since the Great Depression of 1929. Inflation, which was 30 percent during the first months of 1982, soared to 150 percent by year-end and averaged 98.9 percent for the year. The peso was devalued 600 percent. The public sector's deficit reached almost 18 percent of gross domestic product and foreign debt stood at $77 billion.

CURES FOR MEXICO'S ECONOMIC ILLS

During the last 2 years a state of emergency has existed in Mexico as the Government struggled to get the economy under control. It has been a heroic battle, but a stabilization policy is now in place and working. This by no means indicates that the problem is over, but inflation, although still high at approximately 55 percent, is coming down. The balance of payments has achieved an unprecedented surplus. International reserves exceed $7 billion, and public sector debt as a percentage of gross domestic product has been more than cut in half. From a banker's point of view, success is measured by the fact that Mexico is meeting its international debt obligations.

However, Mexico's progress to date was all put into perpective earlier this week for me by a Mexican businessman friend of mine. He said that dealing with the earliest stages of a crisis is relatively easy because the available options are so limited. It is not unlike a person lying in the street after being hit by a car. One must quickly check the extent of the injuries, administer immediate first aid, call an ambulance, and offer comfort appropriate to the situation. It is only later when the injured party has been hospitalized and stabilized that the most profound discussions and difficult decisions are made regarding the extent of the damage, the length and form of the therapy, maybe including drastic surgery, and the extent of the convalescent period before normal activity is resumed.

IMPORTANT RECOVERY YEARS FOR MEXICO LIE AHEAD

That analogy suggests that the most important years for Mexico's full recovery lie just ahead. The country has no choice but to continue to grow. Population pressures prohibit it from doing otherwise. The growth can only occur with adequate capital to support it.

Developing countries such as Mexico by definition are importers of capital. To be a developing country is to be in debt. There is no doubt about the necessity. The question is: What form does the capital import take? In the past it has been a combination of direct investment and lending. But I am suggesting to you today that important swings are now under way in the makeup of the foreign capital component of the package.

According to my own rough calculations, in 1971 Mexico owed approximately $1 in total external debt for every $1 in foreign investment that was registered in the country. By 1982 there were approximately $8 in external debt for every $1 in foreign investment. To say that the relationship got totally out of kilter during this period would be an understatement.

BANK LENDING PROGRAMS FOR MEXICO

During the 1970's, especially from 1974 on, foreign banks were heavily involved in lending into Mexico. We could get into some of those reasons for the lending, but this is not the purpose of these particular hearings. Suffice it to say that foreign bank lending to Mexico has fallen dramatically during the last 2 years and is expected to show a net increase of no more than $4 billion for 1984 and 1985 compared to 1981 when it increased by $25 billion in a single year.

By all indications the role of foreign commercial banks in providing continuously needed capital in the near future will be greatly diminished. We are absolutely not in a position to play a more active role at the moment. The Congress, the regulators, our shareholders and our own boards of directors are all telling us that we have passed prudent limits.

Mexico hopes, and I so do I, that for the immediate future foreign commercial banks will continue to maintain and perhaps even moderately increase short term lines of credit to finance trade flows.

GROWTH FROM DIRECT FOREIGN INVESTMENT

Where do additional funds come from if Mexico is going to continue to grow? The logical answer would be an increasing role for direct foreign investment. Assuming that conditions are such that investor confidence in Mexico's economic stability is restored, you may readily agree with the inevitable logic of my conclusion. However, this does not make it easy for the Mexico Government to openly accept and politically implement an aggressive program to attract foreign investment.

In my opinion Americans have a knack for publicly backing the Mexicans into a political corner, and then are always surprised that they come out kicking rather than passively accepting the comforting confines of the encroaching walls. Let me give a recent example.

In September of this year a major conference sponsored by Euromoney magizine was held in Mexico City, entitled "Mexico: a new area in trade and investment," it was attended by several hundred senior business people, bankers and government officials from around the world. I was asked by one of my colleagues whether I

thought that it was a bit premature to talk about a new era for Mexico. I assured him the timing was excellent, and that I had great hopes for raising the consciousness of some of the participants on the potential for foreign investment in Mexico.

Unfortunately, these hopes were dashed when the conference moderator, a former senior United States Government official, so aggressively stated in his opening remarks what Mexico must do in the way of foreign investment concessions that he immediately put Mexican Government officials on the defensive in this very public forum. In quick succession the Mexican Minister for Planning and Budget unfortunately discovered a conflict which kept him from giving the opening day luncheon address and the Under Secretary of the Ministry of Commerce and Industry used his next day keynote address to defend Mexico's sovereignty and present foreign investment law rather than plowing the new ground which had been hoped for.

FLEXIBLE ATTITUDE BY MEXICO TO FOREIGN INVESTMENT LAW

There are some positive signs that would indicate that Mexico is taking a more flexible approach to interpeting the 1973 foreign investment law. If the potential foreign investor can show that by the investment substantial jobs would be created or products will either be exported or substituted for imports or desirable technology will be transferred, then he will have his proposal seriously reviewed. The potential for approval is heightened, of course, if the whole transaction can stay off the front pages of the Mexican newspapers.

The fall 1984 issue of Foreign Affairs features an article entitled "Mexico, the new challenges," written by President Miguel de la Madrid. As he discusses the relationship between nations he states: "Grand interpretations have been replaced by reality, while dogmas have been overturned by pragmatism." I believe this is very much the approach that his administration is taking in dealing with its economic problems and that could genuinely open up a new era for foreign investment.

He goes on to say, "Relations must be reconstructed with realism as well as sound principles, with audacity and imagination, but also with responsibility." It is within this contex that I wish to congratulate you, Senator, for the blueprint for a Mexico-United States investment in venture capital program. This is an approach which has all of the desirable qualities mentioned by President de la Madrid.

As the proposal is examined further, it is important that we keep in mind that the Mexicans, like the Japanese, are very conscious of saving face. A successful approach will include them as full partners and solicit wide input from Mexico, as well as from the United States.

The Valley National Bank has been operating in Mexico for more than 40 years. Historically we have been lenders to the Mexican private sectors and are always sensitive to the desires and fears of that important group. Because of the very different relationships between the governments of our two countries with their respective private sectors it has not always proven easy in the past

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to get the Mexican businessman to openly support any proposal which appears to be a government project. For that reason, the open and active participation of the U.S. private sector with our own government as their initiative goes forward is critical.

I pledge my own personal support to seeing that the blueprint presented here today receives an honest appraisal on both sides of the border.

Thank you very much.

Senator DECONCINI. Mr. Rapp, thank you very much. Your prepared statement follows.

[The statement follows:]

PREPARED STATEMENT OF WILLIAM K. RAPP

VICE PRESIDENT

VALLEY NATIONAL BANK

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By all indications, the role of foreign commercial banks in providing continuously needed capital in the near future will be greatly diminished. We are absolutely not in a position to play a more active role at the moment. The Congress, the regulators, our shareholders and our board of directors are all telling us that we have passed prudent limits.

Mexico hopes—and so do I—that for the immediate future foreign commercial banks will continue to maintain, and perhaps even increase, short term lines of credit to finance flows.

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ROBBINS & GREEN LAW OFFICES

STATEMENT OF VERNON PENNER, PHOENIX ATTORNEY, ROBBINS & GREEN LAW OFFICES

GENERAL TOPICS RELATING TO MEXICO

Senator DECONCINI. Mr. Penner.

Mr. PENNER. In order not to make it too boring——

Senator DECONCINI. We'll put your full statement in the record.

Mr. PENNER. Otherwise it would be a dry repetition, although I may wish to read some of it.

First of all, I want to address just general topics relative to Mexico.

Before I do that, in other words, so you and the persons that later read these hearings will understand where I'm coming from, as they say, I spent a good majority of my life living in Mexico, growing up there.

I am an attorney at law licensed in Mexico. I'm counsel of a local law firm. I feel as much, if not more, from there as I do from here. I am kind of a strange being. I feel that I belong to both places. Although I do have at times constructive criticism, I do feel very close and dear to Mexico. I do understand the need for foreign investment and the desire for foreign investment in Mexico has always existed in Mexico, but anyone who reads the history of Mexico understands the founded fears of Mexicans, and Mexico in general of an overcasting of the foreign investment on the local market.

BETTER UNDERSTANDING NEEDED OF MEXICAN LAWS

I think really right now what should most be looked into is a better understanding of the laws and system that exists in Mexico by the foreign investor. Day in and day out I will encounter Americans who, although they are willing to drop $10,000, $20,000, $100,000, $10 million, $20 million in Mexico, don't know what they're getting into. Day in and day out I see people putting deposits, I see people spending money and they're doing it without prior information. They're assuming when they should be studying. The system of Mexico is different than that of the United States. The mentality is different than that of the United States.

We must understand that they are sovereign people and judge them as such. On the other side, I feel that Mexico in turn should clarify and identify norms which they are presently applying which have no foundation other than using administrative criteria.

Once again, on the American side the United States citizens are constantly looking for ways to invest in Mexico. This investment sometimes takes forms which are not either foreseen or are sometimes restricted to a certain limit in Mexico and it apparently doesn't affect the American.

Therefore, I would suggest that both for the benefit of the American, as well as Mexico that these areas be covered by lawful regulation and the investment be permitted on an above-board, open basis protected by Mexican laws rather than doing it clandestinely.

RECOMMENDATION FOR IN-BOND PROGRAM

I definitely feel from a personal point of view that the United States should continue its nonintervention in Mexico's sovereignty and to allow Mexico to solve its economic and social problems. But where a neighbor requests assistance it should be granted. I speak relative to an in-bond program, which is also known as a Maquiliadora Program. It has been very aggressively south in Mexico and is a good source of income for Mexico, as well as infrastructure development for Mexico, and I foresee in the future it will continue to be so.

Recently I have seen, although very restricted and limited, there are United States banks that are once again lending in Mexico, although it is not in the same amount nor in the same quantity.

Yes, there is still flight of capital from Mexico. Mexico, of course, realized after some time that it could not stop or absolutely control capital and, therefore, reopened, if you will, the market on exchange of foreign currency for pesos. This unfortunately will not stop in the near future unless Mexico can find a way, as it apparently is finding a way to implement the business climate from a favorable point of view.

INVESTMENT IN EDUCATION

Mexico in the last 20 years or so has been investing a lot of money in education. I feel that this is a very progressive attitude and is producing a very well-educated middle class which previously did not exist for all practical purposes in Mexico. Nevertheless, we see growing pains now in view of the fact that because of the education that is implemented in Mexico they have professionals in Mexico who can't find jobs in their profession. At the same time with the education implementation in Mexico, we find individuals who think more relative to their society, politics, and world business, which will bring more awareness to Mexico in general of the countries abroad and investment and the philosophy of neighbors.

Going on farther, I wish to read a few, if I may, comments from my prepared statement.

FOREIGN INVESTMENT IN MEXICO

Mexico has sustained substantial foreign investment both directly and indirectly over the past several centuries which has been a blessing to Mexico, but at the same time has been a pain.

Additionally, in the recent past Mexico has sustained in both its public and private sectors a substantial amount of investment from the United States private sector. This is both, of course, from the financing community, as well as the manufacturing, services and investment community.

I think that it is wise to make note that there is an equality both for foreigners and nationals in Mexico. Mexico, although I will not say has copied, I will say is very similar to the United States in its judicial and lawful organization creating both a federal, as well as state constitutions and creating a hierarchy of laws, with a two-house Congress and a President, creating a defined bill of rights in

its constitution granting both foreigners, as well as nationals the same basic rights.

Mexico must maintain its sovereignty. There is investment in the Mexican public sectors. Mexico's public sector has traditionally received United States private investment by accepting, among other things, loans from United States banking and financial institutions.

Additionally, United States individuals and United States corporate entities have traditionally contracted with Mexico's public sector to either sell merchandise or render services to Mexico's public sectors and continues to do so.

To bring some light upon dealing with the Government per se in Mexico from a private enterprise point of view, I wish to point out that there are companies or entities that are subject to the centralized budget and not subject to the centralized budget. Those that are subject to the centralized budget have only that budget which is granted them by the Congress of Mexico during each year, and if the expense to be incurred by that agency in contracting foreign currency or foreign merchandise or foreign service would not be foreseen, therefore, not payable, the noncentralized budget, of course, grants these agencies or others their own budget granting them the ability to contract on their own with these foreign entities.

It is wise to note that there are registries in Mexico for doing different sorts of activities, such as registering for contracting with the public sector of Mexico without which the foreign entity could not do so.

CALVO DOCTRINE

There is a doctrine in Mexico known as the Calvo doctrine, which is a most important doctrine to Mexico which basically states that a foreigner in order to perform certain acts in Mexico that will give him rights in Mexico must agree to consider himself as a Mexican with respect to these rights and obligations he acquires and not to invoke the protection of his government with respect thereto under the penalty that if he does attempt to invoke the protection of his government, he will lose all the required rights in favor of the Mexican Federal Government. What Mexico is saying is we invite foreign capital but we wish you, if you want to invest in Mexico, also to live by our rules.

There are other registrations such as for suppliers and for lenders which I will not go into detail at this time.

They are very important for those who wish to participate in those activities.

INVESTMENT IN MEXICAN PRIVATE SECTOR

Investment in the Mexican private sector goes without saying that it is more than substantial. The United States, traditionally because of the closeness between the two countries and because of the—if you want ot call it that—foreign market possibilities, has constantly and traditionally invested large amounts of money in all areas of investment permitted by Mexico.

Just a reference to general topics. Mexico has very clearly defined which sectors allow foreign investment and which don't. In my writing I refer to activity referred to the Mexican Government. This requires that only agencies of the Mexican Government can participate in these business activities which would not only do away with partner participation but as well as Mexican private participation. There are activities reserved solely for Mexican nationals and Mexican activities. There are activities reserved only for Mexican nationals, per se. There are activities which are normally reserved for Mexican nationals, but in certain cases would allow foreign participation.

There are other sectors of the investment market which allow foreign capital to participate in a limited manner.

RULES FOR PARTICIPATION IN INVESTMENT IN MEXICO

To those who are addressing the Mexicans for the first time, they must recognize that there is a general rule of participation which says 49 percent foreign capital, 51 percent Mexican capital. I want to reserve the right to maintain my sovereignty and my economic independency.

In addition to this, there are times that 49 percent is reduced even more when dealing with sectors of the industry.

Going on farther, there are also cases, as Mr. William Rapp indicated, where increased foreign capital has been permitted in the past years, and even this year ground is being cut where they can see advancement in technology. They can see an advancement in labor use, as well as in capital increment. To mention a few would be to mention high technology, such as computers, would be to mention hotels and motels in the tourist sector and, of course, the in-bond or Maquiliadora industry along the United States-Mexico border as well as the interior.

REAL ESTATE INVESTMENT BY U.S. INDIVIDUALS

One part of U.S. investment which is not really foreseen or talked much about is real estate. The amount of money invested by U.S. individuals in participation either in commercial ventures of hotels or motels or condominiums or even private residences is large to say the least. Mexico seems to have an overabundance of tourist or retirement areas in Mexico for foreigners.

There are a group of laws which deal specifically with foreign investment, not only giving the foreigners rights but to restrict in certain areas.

THE LEGAL RAMIFICATIONS OF DOING BUSINESS IN MEXICO

In conclusion, I would mention that foreign investment is restricted by law to a minority position with exceptions. If business or investment is performed in Mexico, the businessman or investor can expect an investment to be subject to Mexican laws or taxation, which a lot of Americans don't appear to recognize. The laws of Mexico are different as comnpared to the United States. More responsibility is placed on the foreign investor relative to protecting his interest in Mexico as compared to the United States. Al-

though the investment by the U.S. individual company will most likely be made in U.S. dollars than Mexican pesos permitting him to return the investment or any property in pesos.

MEXICO RELATIONS

Possible suggestions would be to provide for better education of the United States investor relative to what to expect in Mexico, provide for education of the Mexican receptor or partner relative to what to expect from the American investor, provide for more definition in certain regulations pertaining to Mexican law relative to foreign investment, provide new means to receive United States capital for assistance to renew the Mexican economy.

In addition, if I may, in closing say I think it would behoove all individuals and corporations of the United States to do additional investigations in their investments in Mexico before they, as they say, put the money on the line. There are plenty of books that have been written, and there are constant news synopses coming from Mexico in English for those who want to know what's going on in Mexico, and I would highly recommend that they read as much as possible.

Thank you, Senator.

PREPARED STATEMENT

Senator DECONCINI: Thank you, Mr. Penner. Your prepared statement will be placed in ther record at this point.

[The statement follows:]

PREPARED STATEMENT OF VERNON D. PENNER

ATTORNEY-AT-LAW

ROBBINS & GREEN

Honorable Senator DeConcini:

Per your request, I hereinafter propose the following as a basis for general review and discussion in the above mentioned hearing.

1. Introduction

Mexico (United Mexican States) has sustained substantial foreign investment, directly and indirectly, over the past several centuries.

Additionally, in the recent past, Mexico has sustained, in both its public and private sectors, a substantial amount of investment from the United States (United States of America) private sector.

Although Mexico's public and private sectors have traditionally received United States private sector investment with a favorable attitude, Mexico has felt the need to regulate the investments in order to maintain an orderly structure and preserve what it has felt is its economic independence.

1.1. Equality

The Federal Mexican Constitution provides for equality in rights and protections to all individuals independent of, among other, their nationality.

The initial action of the Federal Mexican Constitution is to create a bill of rights for protection of all individuals relative, among other, to ownership, commerce, religion and due process of law.

The constitution, in subsequent articles, places restrictions on foreigners by granting the authority for regulatory laws restricting foreigner activities.

2. Investment in the Mexican Public Sector

Mexico's public sector has traditionally received United States (United States of America) private investment by accepting, among other, loans from United States banking and financial institutions.

Additionally, United States individuals and United States corporate entities have traditionally contracted with Mexico's public sector to either sell merchandise or render services to Mexico's public sector.

2.1 The Centralized Budget

There exists in Mexico a public sector which yearly receives income alloted it by the federal Mexican Congress in the approval of the yearly federal Mexican public sector budget.

If there exists a debt on behalf of any centrally budgeted agency of the Mexican federal government that is not budgeted by the federal Mexican Congress, then this agency wil not have any money to pay this debt and additionally the creditor will not be able to enforce collection through the Mexican court system.

2.2 The Non-Centralized Budgets

There additionally exists a part of the public sector of Mexico that has its own economic resources and does not participate

in the yearly centralized budget process. Thusly, there is no need to obtain the federal congress approval for budgetary purposes.

2.3 Registry for Contracting with the Public Sector

The federal Mexican Law of Nationalization and Naturalization determines that all foreigners and foreign entities as well as all Mexican companies that have or can have foreign partners and shareholders cannot obtain a concession from nor enter into contracts with Mexican municipalities, local governments and federal authorities without first obtaining a permit therefor from the Mexican Federal Secretariat of Foreign Relations.

The basic condition for obtaining this permit is agreeing with and submitting oneself to the terms of the Calvo doctrine.

2.3.1 The Calvo Doctrine

The Calvo doctrine is basically where the foreigner, in order to perform a certain act in Mexico that will give him rights in Mexico, must agree to consider himself as a Mexican with respect to the rights and obligations he requires and not to invoke the protection of his government with respect thereto, under the penalty that if he does attempt to invoke the protection of his government, he will loss all the acquired rights in favor of the Mexican federal government.

2.4 Other Registrations

2.4.1 Suppliers

In order to be a suplier of the Mexican federal government, the foreigner must obtain a registry, renewable yearly, with the offices of the Mexican federal government therefor.

The principal purpose of this registry is for the federal Mexican government to know who it is they are dealing with and whether or not the supplier has the resources with which to meet its obligations.

2.4.2 Lenders

The federal Mexican Income Tax Law foresees a reduced taxing rate on interest earned under a loan made by a foreign financial institution.

In order to enjoy use of the privileges given under this reduced taxing rate, the foreign financial institutions must apply for and receive a registration number for this purpose.

This registry thusly gives the Mexican federal government much wanted information about which institutions are lending in Mexico. Additionally, the Mexican federal government can thusly also request additional information from the financial institutions which will assist it in its taxing efforts.

The foreign lenders normally perform the execution of their lending agreements outside of Mexico, in view of the fact that they are not normally qualified to do so in Mexico.

3. Investment in the Mexican Private Sector

Mexico's private sector has traditionally received United States private investment by accepting loans, partners, suppliers and technology.

The rights of enforcement of the terms of investment in Mexico are enforceable in courts of Mexico, provided they were not

made contrary to the laws of Mexico.

3.1 Financial Institutions

Foreign financial institutions of many countries have traditionally been lending money to and financing purchases of Mexican individuals and business entities.

The United States has a substantial amount of financial institutions, including banks, that have been lending money to and financing purchases of Mexicans for many years.

These lendings and financings are performed under a contractual relationship between the parties that afford protection of their rights in Mexican courts.

3.2 Individuals and Business Entities

United States individuals and business entities have traditionally performed investments in Mexico, through lending, financing, participation in corporate structure, providing supplies and technology and purchasing in the Mexican stock market.

An attempt to identify all the sectors of business in Mexico and means of investment in Mexico where United States business investment can be found, would be difficult indeed.

3.2.1 Sectors of Investment

It would be accurate to say that where the laws of Mexico do not prohibit foreign investment, then foreign investment is permitted.

Where foreign investment is permitted, it is most likely to be found in a greater or lesser degree.

3.2.1.1 Activities Reserved to the Mexican Government

A general classification of those business activities reserved to the Mexican government are:

1. Petroleum and all other Hydrocarbons
2. Basic Petrochemicals
3. Exploitation of Radioactive Minerals and Generation of Nuclear Energy
4. Mining, in some cases
5. Electricity
6. Railroads
7. Telegraphic and Radiotelegraphic Communications
8. The Postal System/Mail

3.2.1.2 Activities Reserved for Mexican Nationals and Mexican Companies (with solely Mexican Nationals)

1. Credit Institutions and Auxiliar Organizations
2. Insurance Instructions
3. Bonding Institutions
4. Investment Companies (handling stocks and bonds)
5. Radio and Television
6. Urban, Interurban and Federal Highway Transportation.
7. National Maritime Transport
8. Air Transport
9. Forestry Exploitation
10. Gas (LP) Distribution

3.2.1.3 Activities Reserved for Mexican Nationals (Individuals)

1. Notaries
2. Public Brokers
3. Members of Stock Exchange
4. Announcers, Chroniclers/Reporters, Commentators (all on television or radio)

5. Navy and Air Force
6. Port Captain and Airport Pilotage and Commandants
7. Customs Agents

3.2.1.4 Activities Normally Reserved for Mexican Nationals (Individuals)

1. Tourist Guides
2. Directive Members of Chambers (like Chambers of Commerce, Transformation, etc.)
3. Army
4. Police/Public Security Forces

3.2.1.5 Activities in which Foreign Capital Participation is Limited

In addition to considering the general rule that unless otherwise stated in law ordinance, foreign investment participation in business is limited to 49% of the capital investment, management rights and potential earning, there are cases of additional restriction, such as in:

1. Exploitation and utilization of Mineral Substances
2. Secondary Products of the Petrochemical Industry
3. Manufacturing of Automotive Components
4. Pisciculture and Fishing
5. Arms, Munitions and Explosives
6. Siderurgical, Cement, Glass, Fertilizer, Cellulose and Aluminum Industries
7. Cinematography Industry
8. Companies dedicated to the Production of Carbonated Water and Bottled Refreshments
9. Editorial and Publishing Companies
10. The Rubber Industry
11. Agriculture
12. Department/Grocery Stores
13. Toiletry and Beauty Articles
14. Consignatory Agents of Ships

3.3 The So-Called Johnson Law and the Mexican National Banking Insurance Commission

Due to the issuance in the United States of the so-called Johnson Law which requires United States companies to request authorization from their federal government to perform investments in foreign countries, the Mexican National Banking Commission recommended to the Mexican banking institutions that they perform loans requested by Mexican companies solely in that portion which the Mexican capital represents in these companies.

3.4 The 49%/51% Rule

The general rule for foreign investment in business ventures in Mexico is that the foreign investment should not exceed 49% of the capital investment, administration and profits. Nevertheless, there are cases where increased investment is permitted.

3.5 Cases of Increased Foreign Investment

Where the Mexican government can see a maximization of benefits to Mexico which outweigh any possible detriments to Mexico, then increased foreign investment is permitted.

The most obvious cases of United States investment in maximization of benefits are where the United States investors invest large sums of capital that will provide many jobs for the Mexican populace or where although the capital investment is not as large, the labor benefits are there without creating undue competition on the local Mexican market.

3.5.1 The "Maquiladora" Industry

There are over several hundred totally or majority owned United

States investor maquiladora assembly plants in Mexico, predominantly located along the United States-Mexico border.

These plants consume, among other, Mexican labor, electricity, housing, LP gas and in some cases, Mexican raw material. All this, without placing most of the finished product on the Mexican market. The plants also produce a positive dollar flow for Mexico.

3.6 Real Estate in Mexico

There has traditionally existed and continues to exist a substantial U.S. investment in Mexican real estate.

This investment has been directly related to Mexican businesses with United States investment, that require the real estate to pursue their principal business goal; U.S. investment in real estate ventures and U.S. acquisition for residential purposes.

Condominiums, hotels and motels, timesharing, private residential clubs and other housing activities are greatly sought after by United States investment.

4. Laws of Mexico Specifically for Foreign Investment

Some of the more prominent laws which are more specifically identified in Mexico as controlling foreign investment are:

1. The Law to Promote Mexican Investment and Regulate Foreign Investment.

2. The Law on the Registration of Transfer of Technology and Use and Exploitation of Patents and Trade Marks.

3. Regulatory Law of the National Registry of Foreign Investment.

4. The Immigration Law and its Regulatory Law.

5. The Fifth Chapter of the Federal Income Tax Law of Mexico titled "Of the Residents Abroad with Income from Sources of Wealth located in the National Territory"

5. The Legal Ramifications of Doing Business in Mexico

A brief overview of the legal ramifications of doing business in Mexico could be said to contain the following:

1. Foreign investment is restricted, by law, to a predominantly minority position, with exceptions.

2. If business or investment is performed in Mexico, the businessperson or investor can expect the business or investment to be subject to Mexican Laws, courts and taxation.

3. The laws of Mexico are different than in the United States and therefore the rights, protections, defenses and opportunities are different in Mexico compared to the United States.

4. More responsibility is placed on the foreign investor relative to his protecting his investment.

5. Although the investment by the United States individual or company will most likely been made in U.S. dollars, the Mexican debtor is protected by Mexican ordinance permitting him to return the investment and any profit in Pesos, currency of Mexico.

6. Strengthening United States-Mexico Relations

Possible suggestions to strengthening the relations between the U.S. and Mexico from an investment point of view might be:

1. Provide for better education of the U.S. investor relative to what to expect in Mexico.

2. Provide for education of the Mexican receptor or partner relative to what to expect from the U.S. investor.

3. Provide for more definition in certain regulations pertaining to Mexican law relative to foreign investment.

4. Provide new means to receive United States capital for assistance to renew the Mexican economy.

CENTER FOR LATIN AMERICAN STUDIES

STATEMENT OF JERRY LADMAN, DIRECTOR, CENTER FOR LATIN AMERICAN STUDIES

LONG-TERM VIEW OF MEXICAN ECONOMY

Senator DECONCINI. Mr. Ladman.

Mr. LADMAN. Thank you very much, Senator.

It's indeed a pleasure to be with you, and I congratulate you and your committee for holding these hearing in Arizona.

By being the last one on the program, one has the advantage of taking the benefit of what others have said. We can take what I have good to say that will be similar, and what will be different, and that will perhaps put the problem in a different prospective. I shouldn't say the problem. The situation.

As an academic we look at things perhaps in a longer term prospective and try making prognostications, where our colleagues from the Federal Government and banks and law are dealing with daily problems. They look at things in the current situation.

What I intend to do is try to put this in a longer term prospective first by very briefly looking at how foreign investment is involved in Mexico, and see what lesson might be there in terms of projections for the future, and also talk about what I think are some changing conditions that will influence not only the amount but the direction of foreign investment from the United States in Mexico.

MEXICAN SOLICITING OF FOREIGN INVESTMENT

Mexico has aggressively pursued a policy of soliciting foreign investment in the post-World War II era as part of the import substitution policy to establish particularly manufacturing facilities in the country.

Prior to that time the foreign investment was more concentrated in natural resources and public utilities and so forth.

Indeed, in 1981 the stock of the U.S investment reached a total of $6.96 billion. That was about nine times larger than the amount

that was invested in 1960 on the part of U.S. investor measured in current dollars.

There have been marked changes in the structure of this investment since this time. The manufacturing sector from 1960 held just slightly less than half of the stock of United States investment in Mexico. However, by 1981 the amount had risen to almost three-fourths. Between 1960 and 1981 the value of foreign investment in manufacturing increased 13 times. Investment in mining, on the other hand, declined in an absolute amount by 41 percent. Petroleum investment increased rapidly for its size. In 1981 it only accounted for 2.71 percent of the total investment.

Within this growing manufacturing sector two different types of industries in a generic sense have been the largest recipients of the U.S. investment. In 1981 transportation equipment and chemicals accounted for 24.16 and 12.98 percent of the sector total, respectively. This is not to say, however, there's a great concentration, that there's not a number of other sectors receiving investment. Indeed, there's wide dispersion. Food products, primary and fabricated metals, nonelectrical machinery and electrical equipment accounted for about 8.13 to 16.46 percent of the total investment in the sector. So there's a number of sectors that are receiving this investment. This is the situation as of 1981. As I indicated, Mexico actively pursued direct foreign investment. It was only later in the 1970's that they actively pursued foreign borrowing particularly from the foreign banks as a source of financing investment in their country.

FACTORS INFLUENCING U.S. INVESTMENT IN MEXICO

What are the principal factors that have influenced U.S. investment? Seems to me there are three principal factors. First of all, Mexico has been a politically stable country. This counts a lot in terms of long-term investment plans on the part of a firm.

Second it's been a country that's experienced economic growth, and this also counts a lot. In fact, I perceive this to be the most important thing because it creates good opportunities for economic gains for the foreign investor.

Then the third factor has been the Mexican government's foreign investment policy. The policy, as I stated, has been to encourage foreign investment.

LAWS PASSED IN MEXICO TO REGULATE FOREIGN INVESTMENT

On the other hand, we've seen evolving over a period of time a tendency to try to become more protective of their sovereignty of that investment. This was most notable during the regime of President Echeverria from 1970 to 1976.

In 1973 they passed two laws. One was the law to regulate foreign investment and the second was a complementary law which was designed to place controls on the nature of foreign investment and the transfer of technology to Mexico.

I think this pretty well set the stage for the modern day Mexico looking at foreign investment. Some of the features of this legislation have been talked about previously but the principal one is the Mexican nationalization principle which says Mexican owners must have 51 percent of the equity in a foreign-owned corporation.

What happened was there was a major crisis in 1976 in Mexico during the Echeverria administration which really again threw the country in a tizzy. Those years we saw a decline in U.S. investment because of the very nationalistic policies of this administration. However, after this administration went out in disgrace and the Lopez Portillo administration came in, Mexico began to enjoy the oil boom. Beginning in 1977, United States investment again flowed in Mexico in numbers which had been unheard of in prior times.

Of course, with the collapse in Mexico there was a crisis which has been amply described today and I won't go into it. As would be expected, this had a negative impact in U.S. direct investment.

In 1982, the year when the collapse really came about, U.S. stock of U.S. direct investment in Mexico declined very substantially 20.38 percent. The next year after President de la Madrid came to office and decreed his austerity program, it declined to 9.38 percent.

Since the end of 1981, U.S. direct investment had declined 28.19 percent total. As the recovery program as engineered by the de la Madrid administration has been discussed, I don't plan to go into that except to say that I believe that it looks promising in terms of the ability of Mexico to recover from this crisis in the longer term.

LONG-TERM OUTLOOK FOR U.S. INVESTMENT

With this I would like to talk about the long-term outlook for U.S. investment. I believe that the long-term outlook for U.S. investment in direct investment of Mexico is quite favorable. I think there are two fundamental reasons. The first reason is that I think if Mexico is able to finish with its recovery in this period of austerity during the de la Madrid administration that it has the basis to again begin to mount a pattern of very sustained and long-term economic growth. This will be based fundamentally very fortuitously on the oil reserves that they have been able to uncover in the last decade. With the ability to earn foreign exchange in a manner that will allow Mexico to restructure its economy and particularly put emphasis upon its industrial sector trying to make it competitive in world markets so that it can become a major source of exports for Mexico. I think that the long-term economic growth is an important factor.

MEXICAN ECONOMIC SOVEREIGNTY

The question of economic sovereignty and the protective measures that Mexico has raised today I think are very important. They, too, will influence the ability of direct investment during this period.

First of all, I would like to say although Mexico has a very open and very stated policy on foreign investment, it's very pragmatic when it comes to implementing that policy because it also is always willing to make an exception when it thinks exceptions are to the benefit of Mexico. Perhaps the exceptions will become less over time as Mexico is better able to become more self-sufficient, and therefore eliminate the needs for the exceptions. I think the government, in a pragmatic context, will in the future continue to operate in this manner and therefore when it's necessary to bend the

rules or to make it possible for an important investment to come in the country it will happen.

Therefore, the basis of the stronger economic growth, the need for mobilizing foreign savings in the form of direct investment to help them sustain that growth will be means which will encourage U.S. investment.

The U.S. investment, although there will be the sovereignty rules that we've discussed, that they will be applied with pragmatism in order to make the investment come about if it's necessary.

INTERDEPENDENCE OF UNITED STATES AND MEXICAN ECONOMICS

The second reason that I want to talk about for the prospect of foreign investment is the growing interdependence of the United States and Mexican economy, and this is something that hasn't been talked about today. There is little question about the fact that the United States and the Mexican economies are becoming more and more integrated over time. There's all sorts of symtoms that have been around for a long time that are now becoming more than symptoms. We know as a result of the oil boom that Mexico became the United States' third most important trading partner after Canada and Japan. The United States has always been Mexico's dominant trading partner accounting presently for about two-thirds of its total trade. The United States has, of course, become increasingly dependent on Mexico as a foreign supplier of petroleum. The differences in the labor markets have been causing for some time larger and increasing numbers of Mexican workers to enter the United States to find employment. The United States has been and continues to be Mexico's principal supplier of foreign debt and direct foreign investment. Under the conditions of overvalued currency, Mexicans are placing considerable funds in the United States. Both in banks and in real investment. Along the common 2,000-mile-long border of the two countries have developed regional economies that are highly interdependent. What was happening was notable in both countries, and the powerful forces at work in the labor and capital markets.

The outlook is for even more integrations specifically as policymakers in both countries become more cognizant and convinced of the strength of the underlying factors at work. This will require a more open attitude and willingness to cooperate on the part of both countries and their governments but it will occur.

Indeed, I have had the good fortune to participate in a major workshop sponsored by the University of Texas and the Mexican Sub Ministry of Commerce and Industrial Development in April and August of 1984, at which high level persons from the government and private sectors of both countries came together to discuss strategies and policies for this to occur.

APPLICATIONS FOR DIRECT INVESTMENT

The applications of this process for U.S. direct investment I think are clear. The United States, a country rich in capital and technology but with high-priced labor, will increasingly look for means to remain competitive by employing its financial and tech-

nological resources in countries that can offer low-cost labor and infrastructure. This phenomenon has been evolving for many years under the multinational enterprises and U.S. off-shore industries. Indeed, the Mexican border assembly plants have been major participants in the latter. With Mexico's emphasis on industrialization and becoming competitive in world markets for manufactured goods that it will undoubtedly look to foreign investment to meet its goals. Not only will it be wanting to expand production of existing goods but also in its plans to become an important producer of capital and intermediate goods.

Therefore, for these reasons the U.S. firms and I think the United States will have the advantage in participating in this process because the United States at the present time, as we all know, its economy is undergoing a restructuring process where we're shifting away from manufacturing of many of the types of industries that Mexico would like to establish.

The United States I think will look to the Mexican market as a source of carrying out its competitive position but under the conditions which I just described.

It must be recalled, however, that Mexico will insist on sovereignty. The United States investor will have to satisfy the Mexican laws. In most cases joint ventures will be required.

TRADE OUTLOOK FAVORABLE

In conclusion, in spite of the downturn of U.S. direct investment following the 1982 economic crisis, the outlook is favorable. Mexico's need for investment capital, the strong probability the Mexican economy will recover from its current crisis and once again enter a strong growth in combination with restructuring of the United States economy are forces that should bring this about. United States investors will need to be sensitive to Mexico's rightful concern over its sovereignty.

United States-Mexico relations have gained in the last 15 years. At this time, however, foreign investment has not been a priority issue, taking a distant back seat to matters of petroleum, trade, and migration. In the longer run, it will ascend in importance as the two countries continue to work together for their mutual economic benefit.

I thank you very much. It's been a pleasure. I'll respond to questions.

PREPARED STATEMENT

Senator DECONCINI. Thank you, Mr. Ladman. That's very helpful. We will insert your prepared statement in the record.

[The statement follows:]

PREPARED STATEMENT OF DR. JERRY R. LADMAN

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Introduction

The Mexican economic crisis of 1982 sent shockwaves throughout the U.S. with all its implications for the U.S. banking system that had an exceedingly large exposure of debt with its southern neighbor, U.S. businesses that were Mexico's chief suppliers of the country's imports, U.S. border businesses that depended on Mexican shoppers, the flows of Mexican undocumented workers coming to the United States, and U.S. firms that hold direct investments in Mexico. This testimony deals with the latter. It is organzied as follows. First, a brief overview of the historical role of U.S. direct investment in Mexico is presented. Second, factors that influence this investment are set forth. Third, the impact of the 1982 crisis on the investment is established. Fourth, the outlook for future U.S. investment is presented. The testimony ends with brief conclusions.

An Overview of U.S. Direct Investment in Mexico: 1960-1981

Since World War II, Mexico has aggressively pursued a policy of using direct foreign investment as a key element in its drive to industrialize through import substitution. U.S. firms have been overwhelmingly the principal investors. In the late 1970s and early 1980s, they accounted for about two-thirds of the total.[1] In 1981, the stock of U.S. investment reached a high of 6.96 billion dollars, almost nine times larger than the amount in 1960, measured in current dollars

In the period since the war, there have been marked changes in the structure of U.S. direct investment in Mexico. The manufacturing sector has always been the largest recipient. Moreover, as shown in Table 1, investment in this sector has become increasingly important, going from about one-half of the volume in 1960 to almost three-fourths in the early 1980s. Between 1960 and 1981 (the highest year) its value increased 13 times. In this period, there was also strong growth in the combined trade, finance and "other" sectors, but the relative importance declined from 30.53 to 22.35 percent. Investment in the mining sector experienced an absolute decline of 41 percent; going from 16.33 to 1.11 percent of the total. U.S. investment in the petroleum sector, after declining in the early 1970s, shot upward during the petroleum boom. Never-the-less, it only accounted for 2.71 of total investment in 1981.

Within the manufacturing sector, two industries have been the largest recipients of cummulative U.S. investment; in 1981, transportation equipment and chemicals accounted for 24.16 and 21.98 percent of the sector total, respectively. There is, however, wide dispersion of U.S. investment in other industries; in 1981, food products, primary and fabricated metals, non-electrical machinery, and electronics and electrical equipment each accounted for between 8.13 and 16.46 percent of total U.S. investment in the sector.

Factors Influencing U.S. Investment

The three principal factors influencing U.S. direct investment have been Mexico's continuing political stability, the perceived opportunities for near and long-term gain associated with the economic growth of the Mexican economy and the Mexican government's foreign investment policy.

Mexican policy has been to encourage foreign investment, however, with the increasing condition of domestic participation in ownership. The latter condition reflects Mexico's committment to maintaining

soverignty, which has been the primary factor underlying Mexico's foreign investment policy,[2] and understandably so, given the predominant position of the United States.

In 1973, two major laws were passed that reaffirmed this position and tightened conditions for foreign investment. The Law to Regulate Foreign Investment stated that all new foreign investment must have at least 51 percent domestic ownership (previously the rule was applied selectively) and must satisfy seventeen criteria on soverignty. The complementary Law to Regulate the Transfer of Technology was designed to ensure that all new and existing arrangements to transfer technology, including royalty and licensing agreements, were equitable for Mexican parties. The 1973 legislation also specified that foreign investment should be directed principally to sectors that were not adequately served by Mexican interest. This was reaffirmed in the development plans of the López Portillo administration (1967-1982), where emphasis was placed on the development of the capital goods industry.[3]

After some initial consternation, especially during the turbulent years of the last half of the Echeverría administration (1970 1976) the policy changes were taken in stride by U S. firms. The new initiatives were in keeping with the norms for foreign investment in many less-developed countries, and most companies felt the long-run opportunities in Mexico warranted accomodation to the legislation. The oil boom, which began in 1977, was a major factor in attracting new U.S. investment. Between 1977 and 1982, annual capital expenditures grew by 247 percent; with over 80 percent of the increase in manufacturing.

The Impact of the Mexican Economic Crisis of 1982

There was scant recognition that the oil boom was destined for collapse as early as 1982 until the Mexican peso began to come under severe pressure in late 1981. The 57 percent devaluation in February,

1982, was the first major signal and created apprehension among foreign investors. When the López Portillo government was unwilling or unable to bring things under control, the devaluation in August of the same year, which put the rate of exchange for the U.S. dollar at about six times its level at the beginning of the year, was very discomforting to U.S. investors, especially since Mexico was holding a foreign debt of 80.8 billion dollars and was virtually out of its reserves of foreign exchange. As shown in Table 1, in 1982, the stock U.S. direct investment in Mexico declined substantially, 20.38 percent.

When the new president Miguel de la Madrid took office in December of 1982, there were few options for action if Mexico wanted to recover from its crisis. Mexico had to bite the bullet of austerity in order to gain the foreign exchange to service its huge external debt and to reduce the inflationary forces that had been set in motion by reckless deficit spending and the subsequent devaluations. With IMF financing, early success in rolling over much of the debt and austerity in federal spending and wage increases the De la Madrid administration posted an admirable record. In 1983, inflation declined 80.8 percent from the level of 100 percent in 1982; Mexico experienced a current account surplus for the first in decades; and the government deficit was reduced to 8.5 percent of GDP, compared to 17.9 percent the previous year. Growth was slowed, however; GDP fell 4.7 percent and real wages declined.[4] Given this situation it is not surprising that the stock of U.S. direct investment continued to fall, but by a much smaller amount than the previous year, by 9.38 percent. Therefore, compared to the end of 1981, U S. direct investment had declined 28.19 percent.

The performance of the Mexican economy in 1984 is equally encouraging. In the president's September 1, State of the Union Message, he reported that industrial output had risen 7.2 percent in the first five months, holdings of international reserves had risen significantly, inflation was projected to fall to about 48 percent, and that GDP was

expected to grow slightly.[5] One week later, on September 7, Finance Minister, Jesús Silvia Herzog, added to the optimism when he announced that Mexico had a successfully obtained an agreement in principal to restructure 48.5 billion dollars of its 96 billion dollar foreign debt, which would extend terms for repayment of up to fourteen years and is expected to save Mexico 14.7 billion dollars in interest.[6]

Outlook for U.S. Investment

Whereas the current crisis has caused a cutback in U.S. direct investment, the longer-term outlook is favorable for two basic reasons: the prospect of renewed economic growth with economic recovery and the growing interdependence of the U.S. and Mexican economies.

The speed with which the realization of the potential for increasing U.S. direct investment comes about will depend upon the success of the De la Madrid government in restoring economic stability. Although the government has been successful, to date, in engineering recovery via austerity, the government is under increasing pressure to "ease off" in its austerity policies especially among the laboring and middle classes, which have been hurt severely by the measures and are being asked to continue to tighten their belts. With the wealthier groups, tax reform is unpopular. If the De la Madrid government succombs to these pressures and relents before economic conditions warrant, economic recovery will be set back.

Long-term Growth

Mexico has the basis for long-term economic growth. As before the current crisis, Mexico's vast hydrocarbon reserves will provide a solid basis to earn foreign exchange and government revenues to help finance development. The current crisis has forced Mexico to both come to grips with internal stability and to look to foreign markets to export

manufactured goods. The latter is necessary to provide much of Mexican industry with the economies of scale that it needs to expand and enhance its cost efficiency.

U.S. direct investment will undoubtedly gain with this growth and the orientation toward exports of manufactured goods. A shortage of domestic savings will cause Mexico to continue to look to foreign direct investment to finance growth. The composition of the investment should continue to change. Although the manufacturing sector will maintain its predominate share, it is expected that Mexico, as was called for under the López Portillo government's economic plans, to encourage new investment in capital and intermediate goods industries, which should serve to attract new firms, or divisions of existing firms, into Mexico.

With the devaluations, Mexican wage rates became relatively low internationally. This condition should remain for some time. The long-run supply of inexpensive but well-qualified labor will be another inducement to U.S. investment. Indeed, assembly plants for export, similar to those at the border, have already been established in the interior of the country. More will be said on this in the following section.

Mexico's concern over excessive dependency on the United States will have important implications for U.S. investors, as Mexico will try to diversify its foreign investment. The United State's position, however, is strongly entrenched. The long historical relationship has established a solid presence of U.S. business in Mexico and their associated technological and managment linkages, that should ensure future ties to product lines and capital goods. Moreover, there are well-developed networks in the two countries that provide information about new investment opportunties, and the Mexican population has developed preferences for American products. All of these factors should combine to ensure good opportunities for U.S. firms.

Intergration of the Two Economies

It is becoming increasingly recognized that the U.S. and Mexican economies are becoming more integrated.[7] By 1981, Mexico had become the U S.'s third most important trading partner, after Canada and Japan, and the U.S. maintained its dominant position as Mexico's most important source of foreign trade, accounting for about two-thirds of the total. The United States was becoming increasingly dependent on Mexico as a foreign supplier of petroleum. The differences in labor markets were causing large and increasing flows of Mexican workers to enter the United States to find employment. The U.S. was Mexico's principal supplier of foreign debt and direct foreign investment and, under conditions of an overvalued currency, Mexicans were placing considerable funds in U.S. bank accounts and real investments. Along their common 2,000 mile-long border the two countries had developed regional economies that were highly interdependent. What was happening was inevitable, given the relative levels of economic development in both countries and the powerful forces at work in labor and capital markets.

The outlook is for even more integration, especially as policy makers in both countries become more cognizant of and convinced about the strength of the factors at work. This will require a more open attitude and willingness to cooperate on the parts of both countries and their governments, but it will occur. Indeed, I had the good fortune to participate in a major workshop, sponsored by the University of Texas and the Mexican Sub Ministry of Commerce and Industrial Development in April and August of 1984, at which high-level persons from the government and private sectors of both countries came together to discuss strategies and policies for this to occur.

The implications of this process for U.S. direct investment are clear. The United States, a country rich in capital and technology but with high-priced labor, will increasingly look for means to remain competitive by employing its financial and technological rsources in

countries that can offer low-cost labor and infrastructure. This phenonomon has been evolving for many years under the multinational enterprises and U.S. off-shore industries; indeed, the Mexican border assembly plants have been major participants in the latter. With Mexico's emphasis on industrialization and becoming competitive in world markets for manufactured goods it will undoubtedly look to foreign investment to meet its goals. Not only will it be wanting to expand the production of existing goods, but also, it plans to become an important producer of capital and intermediate goods. For reasons mentioned above, U.S. firms should have the advantage in participating in this process. It must be recalled, however, that Mexico will insist on soverignty. U.S. investors will have to satisfy the Mexican laws; in most cases, joint-ventures will be required.

Conclusions

In spite of the downturn of U.S. direct investment following the 1982 economic crisis, the outlook is favorable. Mexico's need for investment capital, the strong probability that the Mexican economy will recover from the current crisis and, once again, enter a phase of strong growth in combination with the restructuring of the U.S. economy are forces that should bring this about. U.S. investors, however, will need to be sensitive to Mexico's rightful concern over its soverignty.

U.S.-Mexico relations have gained increasing importance in U.S. foreign policy the last fifteen years. At this time, however, foreign investment has not been a priority issue, taking a distant back seat to matters of petroleum, trade and migration. In the longer run, it will ascend in importantance as the two countries continue to work together for their mutual economic benefit.

END NOTES

1. Banco de México, The Mexican Economy in 1983 (México, D.F.: Banco de México, 1983), p. 103.

2. Richard S. Weinhart, "Foreign Capital in Mexico," Mexico-United States Relations, ed. Susan Kaufman Purcell, Proceedings of the Academy of Political Science, Vol. 34, No. 1. (New York: Academy of Political Science, 1981), p. 119.

3. Calvin P. Blair, Economic Development Planning in Mexico Technical Papers Series No. 26 (Ausitn: Office of Public Sector Studies, University of Texas at Ausitn, 1980).

4. Juan Diez-Canedo Ruiz, "The Outlook for the Mexican Economy," in Contemporary Mexico: Crisis and Change, ed. Jerry R. Ladman (El Paso: Texas Western Press, forthcoming, 1985).

5. "State of Nation, Low-key Balance by De la Madrid," Latin America Regional Reports. Mexico and Central America, 21 September, 1984, p. 2.

6. "New Debt Model Approved," Latin American Weekly Report, 14 September, 1984, p. 8.

7. For an elaboration of these arguments see Clark W. Reynolds, "Industrial Strategy and Policy: Mexico and the United States Complementation and Conflict," paper presented at Workshop on Industrial Strategy and Policy: Mexico and the United States, University of Texas at Austin, April 27-28, 1984.

TABLE 1: U.S. DIRECT INVESTMENT POSITION IN MEXICO
(end of the year)

Sectors	1960	1970	1975	1980	1981	1982	1983
	INVESTMENT (millions of current dollars)						
Mining	130	151	80	95	77	a	a
Petroleum	32	33	21	150	189	193	85
Manufacturing	391	1,191	2,433	4,489	5,140	4,110	3,680
Trade, Finance and Other	243	399	643	1,255	1,556	b	b
Total	796	1,774	3,177	5,989	6,962	5,544	4,999
	PERCENT OF TOTAL INVESTMENT						
Mining	16.33	8.51	2.52	1.59	1.11	a	a
Petroleum	4.02	1.86	0.66	2.50	2.71	3.48	1.70
Manufacturing	49.12	67.14	76.58	74.95	73.83	74.13	73.61
Trade, Finance and Other	30.53	22.49	20.24	20.96	22.35	b	b
Total	100.00	100.0	100.00	100.00	100.00	100.00	100.00

SOURCES: Survey of Current Business, August 1961, October 1971, August 1976, August 1982, and August 1984.

a: Suppressed to avoid disclosure of individual firms.

b: Partially suppressed.

General Questioning

INCREASED UNITED STATES LOANS TO MEXICAN PRIVATE SECTOR

Senator DeConcini. Let me go back to Mr. Rapp, who is in the banking area. Maybe you don't know what the rest of your industry is doing. Do you see an upturn in the willingness to loan to the private sector in Mexico from a year ago?

Mr. Rapp. Senator, I think the problem there is that there have not been all that many banks who have concentrated their lending into the private sector in the first place. I think our own bank is an exception in that particular sense. The perception is always that debt to the private sector is an inferior position to debt to the public sector. In the event of exchange controls the private sector will always be second in line after the public sector.

Senator DeConcini. Which is what happened.

Mr. Rapp. Which is what happened. That is correct.

There is not a great deal of lending that goes to the private sector I think for the most part, especially to those private sector companies who in the course of their business do not generate dollars. If they are exporters or in the tourism business or providing services under contract for dollars, then they have a much better chance of getting looked at.

PAYMENTS FROM PRIVATE SECTOR DEBTS

Senator DeConcini. Are you receiving payments now from private sector debts? For awhile you were not. That's correct.

Mr. Rapp. Yes, we are Senator. Our own position is very much on the record because in our quarterly financial statements at the bank or annual statements we have a very detailed break-out as to what our position is. We had been receiving payments from the private sector.

Senator DeConcini. For awhile you were not; is that correct?

Mr. Rapp. For awhile we were not. That's correct.

Senator DeConcini. For how long? A year?

Mr. Rapp. Less than that. Six to eight months. It was a period of time of sorting out as to whether there were going to be official Government programs available, what were the sources of——

Senator DeConcini. When I make reference to payment, I mean dollars. You received dollars?

Mr. Rapp. That's correct, Senator. Many of our customers of tradition have been——

Senator DeConcini. They've been willing to pay. It was a national policy that prevented them from paying?

Mr. Rapp. That's correct.

REDUCED DEMAND FOR UNITED STATES LOANS BY MEXICO

Senator DeConcini. You don't see those customers coming in for new loans? It is status quo?

Mr. Rapp. It is status quo because they are concerned themselves about incurring additional dollar debt. They do not see that as attractive. As high as nominal interest rates are in Mexico at the moment, in real terms they are quire attractive with inflation, let's

say, at the 55 percent range it is possible to borrow funds, you know, for 3 or 4 percentage points in the 60 to 65 percent range for pesos and that is fairly attractive financing compared to running the risk of borrowing dollars at what might appear to be an attractive rate but with the devaluation rate it could be expensive.

DOLLAR/PESO EXCHANGE

Senator DECONCINI. Will, if one of your Mexican customers comes in and borrows dollars, are they restricted on how they can convert those dollars to pesos? If they borrow $100,000, can they convert them on the black market down there for double the official exchange rate?

Mr. RAPP. Yes. There's not a great difference at the moment between the official exchange rates and the street rate. Unless in fact it is a new loan which the customer then wants to take in and register with the Mexican authorities, if he borrows the money outside of a registration process, there's no——

Senator DECONCINI. Nobody knows.

Mr. RAPP. There would be no record of it except in our gross reporting to the Mexican authorities which we do.

Senator DECONCINI. You do that on an annual basis?

Mr. RAPP. On a quarterly basis we report to the Central Bank of Mexico as to what our gross exposure is in certain sectors.

Senator DECONCINI. Is that a Mexican law?

Mr. RAPP. If not law, it is one of the requirements as we are registered as a bank to do business in Mexico. It is one of the prices we pay for such registration.

I could clarify that these are gross exposure figures by industry, public, or private sector categories, and not by specific name.

Senator DECONCINI. Mr. Penner.

SPECIAL TAXING RATE FOR FOREIGN BANKS

Mr. PENNER. I concur with Will. It is not a law. It's a condition of registration. The federal taxing authorities of Mexico give foreign banking institutions a special taxing rate which is incurred upon the interest earned from their loans in Mexico saying if you want this special reduced tax rate you can have it. You register with me, but when you register with me and I give you this special rate, you must give me certain information which I'm going to request from you. If you don't comply with these requests, I will then take you off that list. You can still do business but not at the special rate.

WAIVERS ON MEXICAN 51 PERCENT OWNERSHIP RATIO

Senator DECONCINI. When investments are made in Mexico, all of you make reference, or two of you do, about the requirement for a 51 percent dominance by Mexican investors. Is it true that they make waivers?

Mr. PENNER. Yes.

Senator DECONCINI. How does that occur? Does that require a special law or is that a Presidential edict or a Minister of Finance edict or how does that occur if they want to build a Ford plant in

Mexico, and it isn't necessary that there be a 51 percent or more Mexican control?

Mr. PENNER. Shall I answer?

Senator DECONCINI. Please, Mr. Penner.

Mr. PENNER. Yes. As previously mentioned, there's basically three categories they look at. One is labor and one is capital. If they foresee a situation which they would be considering as out of the ordinary benefit for Mexico, then they would take this to the level of the Intersecretarial Commission on Foreign Investment, of which many federal cabinet levels participate, and they would agree amongst themselves that it is of benefit to Mexico to allow this kind of participation to take place. Through the National Commission on Foreign Investment they would allow this to take place by issuing a decree, if you will, through the Secretariat. The other organizations that are heavily participating in it, although there are many, the ones most heavily participating are the Treasury authorities, Foreign Relation authorities and in some instances the labor authorities but mostly the Foreign Investment Commission. It will grant a waiver in conjunction with the authorization which has been granted to allow a majority of foreign capital in that corporation. In other words, it's a special exception to the law, to the law which the 49–51 comes from this foreign investment law of 1973 which was referred to by Jerry.

MEXICAN CORRUPTION PRACTICES IN FOREIGN INVESTMENTS

Senator DECONCINI. Professor Ladman, maybe you're the one who might want to address this problem of corruption in Mexico as it relates to foreign investments. Is that something for foreign investors to be not only aware of but to know how to deal with in Mexico?

Mr. LADMAN. Well, I certainly claim no expertise in this area, but what I can say is just observations I picked up by talking with United States businessmen in Mexico. I used to live there, and I have many of them for friends. They all answer your question and smile and say it's a way of doing business.

Senator DECONCINI. Will, is that your observation, too, it's something that has to be tolerated?

Mr. RAPP. I think the answer is, well, yes or no. Yes and no. It has been a fact of life. It continues to be a fact of life. You can still encounter American businessmen who say I work in Mexico. I work there successfully, and I have never paid a bribe or whatever. That is the type of commentary which is not solicited and in fact not defensive but it seemed to be something that the philosophy of this particular company is very proud of, and they should be proud of the fact that they have been able to operate without doing that. It may also be through the ignorance at the top level that they do not know what all of the levels of their own company are doing. That I cannot tell you. I believe there is a certain wind for change and it is more than lipservice at the moment and that is——

Senator DECONCINI. You think there's some improvement in that area?

Mr. RAPP. I do.

Senator DECONCINI. At least in the commercial——

Mr. RAPP. I do.
Senator DECONCINI. Do you agree, Mr. Penner?
Mr. PENNER. I agree.

GROWING MIDDLE CLASS IN MEXICO

I wish to make two statements. There is a growing middle class and a growing educated middle class and that growing educated middle class is striving hard to make a place for itself in the community, and I have seen many instances where this educated middle class working in government positions prefers the stamp of good approval from their superior for work well done rather than work not well done but money paid. They're hoping for a future rather than for the moment, many of them. Nevertheless, they still have those of what I would call the older school which still do look at it only from a lucrative point of view at the moment.

At the same time I wish to make the statement that it is theoretically and practically possible 99 percent of the time to not have to get involved with the bite or whatever they want to call it. There are cases where you get yourself into a tight spot and if you want fluency in the activity of certain officials it does take place.

OIL RESERVES AND PEMEX AS SOURCE OF HARD CURRENCY

Senator DECONCINI. Mr. Ladman, let me ask you one last question and we'll end. I appreciate your staying so long.

Regarding the oil reserves and PEMEX as a source of hard currency, at present three-fourths of Mexico's foreign exchange earnings are derived from sales by the Government-controlled petroleum monopoly so I'm told. Is Mexico in your opinion actively doing something to diversify the source of required foreign exchange? Do you see any——

Mr. LADMAN. That was definitely part of the national development plan that came about under the last administration of Lopez Portillo. One of the concerns that people had is how much of that really was going to be realized. The collapse came I think on Mexico at a point which did not allow us to see how that plan was going to be played out. I think in many ways the Mexican crisis was a blessing in disguise to Mexico. It is creating hardships on persons in that country, particularly the working-class people and the middle-class people. I think that perhaps more than anything demonstrated to Mexico what really needed to be done in order to achieve long run economic growth in their country. In this context it showed them that they, first of all, could not rely upon petroleum. They could not use petroleum as a resource for quick riches and get away with it. It also showed them that they needed to diversify away from petroleum, and I think this is forcing them toward trying to really get what has been traditionally a highly protected and very inefficient manufacturing sector moving in that direction. I think it was very positive in that context.

SUCCESSFUL EFFORTS AT DIVERSIFICATION IN MEXICO

Senator DECONCINI. Mr. High, do you have anything to add or is Mexico diversifying successfully or is there——

Mr. HIGH. It certainly is making the effort. The Government, as has been mentioned, had announced in the previous administration its effort to turn to the export sector, expand nonpetroleum exports. Not much came of it. The de la Madrid administration likewise has encouraged an effort to expand in the export sector. This particular subsidies agreement is important to Mexico because they feel that with the threat of countervailing duty cases brought against them in the United States, people in Mexico are resistant in putting their own money into new export industries lest as soon as they get part of the American market they have a countervailing duty case thrown at them. That's why Mexico needs foreign investment to help expand that sector. You don't suddenly become an export country by saying by Government decree we are now going into exports. There are all kinds of things you have to do. It takes time. They have a long way to go.

INTEREST IN MEXICO'S FOREIGN DEBT

Senator DECONCINI. Do you know if it's true, professor, that 22.7 percent of the Mexican Government's proposed budget for the coming year will go to payment of interest on Mexico's foreign debt? Is that an accurate figure, or do you know?

Mr. LADMAN. I don't know.

Senator DECONCINI. Do you know, Mr. High?

Mr. HIGH. I don't know off the top of my head. I wouldn't be surprised.

Mr. RAPP. I would say the same without checking the figures. It has to be a significant figure.

Senator DECONCINI. That's a tremendous burden.

Mr. RAPP. The total debt at the moment is in the $90 billion range. If you just assume 10 percent, you're talking about a $10 billion payment.

Senator DECONCINI. I'm informed that's the amount. It's hard to believe a government can function with that kind of percentage of its budget going to debt. We may witness that in our own debt if we continue down the road. At least it's to ourselves, so the speak.

CLOSING REMARKS

I would like to ask all of you, but particularly Professor Ladman, if he has had a chance to look at my proposal, and if not, if you would do so in a critical constructive manner and give me your observation. Same with you, Mr. Rapp and Mr. Penner and Mr. High. I am just looking for some suggestions of where we might go. If it's off the wall and doesn't make sense, I can easily accept that. I'm just looking for some ideas. If I could send that to you and have you review it, I would appreciate it.

Thank you very much, gentlemen. Thank you, Mr. High, for staying.

I want to thank the chairman of the Appropriations Committee, Senator Hatfield, Senators Kasten and Inouye, Richard Collins, and Jane Green, and Lee Stein of my personal staff for helping us put this together today. It's been informative for this Senator and I'm sure it will be to the staffs and other members of the committee and their staffs.

CONCLUSION OF HEARING

The chairman authorized me to hold these hearings, and I'm most indebted. We will stand in recess. Thank you.

[Whereupon, at 5:15 p.m., Friday, December 7, 1984, the hearing was concluded, and the subcommittee was recessed to reconvene at the call of the chair.]

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